FILE COPY

Office Supreme Court, U.S.
FILED
JAMES R. BROWNING, Clerk

IN THE

Supreme Court of the United States

OCTOBER TERM, 1958

No. 236

STERN & STERN TEXTILES, INC. (Successor In Interest to HUGUET FABRICS CORPORATION), *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

PETITION FOR WRIT OF CERTIORARI

To the United States Court of Appeals for the Second Circuit

HOWE P. COCHRAN
421 New Jersey Avenue, S. E.
Washington 3, D. C.
Attorney for Petitioner

Of Counsel:

MARGARET F. LUERS,
BETTY COCHRAN STOCKVIS

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

INDEX

	Page
Opinions Below	2
Jurisdiction	2
Questions Presented	2
Statutes and Regulations Involved	4
Statement of the Case	5
Reasons Relied on for the Allowance of the Writ	14
Summary	14
I. The decision below is contrary to the decisions of this Court	15
(a) Mutual mistake of fact	15
(b) Change in legal climate	18
II. There is a conflict between the circuits in the matter involved	20
III. The Tax Court, under the special statute authorizing it to review refund claims for relief under Section 722 of the Internal Revenue Code, was required to have its decision reviewed by a special division of its members consisting of three judges appointed by its presiding judge. In this case no such review was had, and a motion seeking such review was summarily denied	22
IV. The Tax Court, under the special statute authorizing it to review refund claims for relief under Section 722 of the Internal Revenue Code, did not have authority to apply the rule of collateral estoppel	24
V. The respondent is basing a plea of collateral estoppel on his own mistake and ought not to be allowed to do so	27
VI. The Second Circuit departed from the issues before it in sustaining the Tax Court	28
Conclusion	35
Appendix	1a

CITATIONS

CASES: Page

Commissioner v. *Sunnen*, 333 U.S. 591, 68 S. Ct. 715 15, 16, 18
Davenport Hosiery Mills, Inc., 28 T.C. 201 ..... 19, 20, 29
Fishbeck Awning Co., 19 T.C. 773 33
Hemenway-Johnson Furniture Co., 22 T.C. 43 33
Old Colony Trust Co. v. *Commissioner*, 279 U.S. 716, 49 S. Ct. 499 24
Parker v. *Westover*, 221 F. (2d) 603 ..... 20, 21
Rand Beverage Co., 18 T.C. 275 33
Sunnen, Commissioner v., 333 U.S. 591, 68 S. Ct. 715 15, 16, 18
Union Metal Manufacturing Co., Appeal of, 4 BTA 287 25-27

STATUTES:

Internal Revenue Code of 1939, as amended

Section 722 ..... 5, 10, 14, 18, 19, 21, 22, 24, 28
Section 722 (b) (1) 6, 32
Section 722 (b) (2) 6, 32
Section 722 (b) (3) 6, 32
Section 722 (b) (4) 6, 8, 18, 19, 20, 30-35
Section 732 ..... 23, 24
Section 732 (a) 5
Section 732 (c) 13, 22
Section 732 (d) 4, 13, 22

Internal Revenue Code of 1954

Section 7482 13
Section 7483 13

MISCELLANEOUS:

Bulletin on Section 722 of the Internal Revenue Code (U. S. Treasury Department, Bureau of Internal Revenue, November 1944) 33
53 Stats. 158 USCA § 1100 24
H. Rep. No. 146, 77th Congress, 1st Session, 1941 CB 550-551 28

IN THE

Supreme Court of the United States

OCTOBER TERM, 1958

No.

STERN & STERN TEXTILES, INC. (Successor In Interest to HUGUET FABRICS CORPORATION), *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

PETITION FOR WRIT OF CERTIORARI

To the United States Court of Appeals for the Second Circuit

Stern & Stern Textiles, Inc., a corporation organized and existing under the laws of the State of Delaware (hereinafter referred to as petitioner), successor in interest to Huguet Fabrics Corporation (hereinafter referred to as Huguet), petitions the Supreme Court of the United States to issue a writ of certiorari to the United States Court of Appeals for the Second Circuit to review its judgment entered in the above-entitled case on March 23, 1959.

OPINIONS BELOW

The opinion of The Tax Court of the United States (Appendix 10a) is reported in 26 T.C. 1000. The opinion of the United States Court of Appeals for the Second Circuit is reported in 263 F. (2d) 538 (Appendix 3a).

This case involves an issue of collateral estoppel which brings into play two prior Tax Court opinions written in a single case, one withdrawn, the other final, concerning a tax controversy between the same parties for a prior year. Such opinions are reported in 18 T.C. 605 and 19 T.C. 535, respectively.

JURISDICTION

The grounds on which the jurisdiction of this Court is invoked are the following:

The judgment of the Court of Appeals was entered on February 2, 1959. The order denying the petition for rehearing was entered on March 23, 1959.

On June 15, 1959, the time for filing a petition for a writ of certiorari was extended by order of this honorable Court to and including July 21, 1959.

The jurisdiction of the Supreme Court is invoked under Title 28 U.S.C. 1254 (1).

QUESTIONS PRESENTED

The questions presented are as follows:

I.

Is the doctrine of collateral estoppel applicable in a tax case for later years when the decision in the prior case turned on a mutual mistake of fact?

II

Can the rule of collateral estoppel be invoked in the tax matter of later years when the decision in the prior case turned on the insufficiency of proof, and where the holding of insufficiency of proof was based upon an erroneous and incomplete joint stipulation of facts in the prior case?

III

Can the plea of collateral estoppel be availed of when the facts to be heard in the present case differ materially from those heard in the prior case?

IV

Can the respondent, to the detriment of the petitioner, take advantage of a mistake to which he was a party?

V

Can the plea of collateral estoppel be availed of when there has been a change of legal climate between the prior decision and the present case?

VI

Could the Tax Court, acting under an Order

> "that the Court hear and determine first and apart from the other issues in these proceedings whether the doctrine of *res judicata* and/or collateral estoppel bars the petitioner as a matter of law from a hearing on the merits"

review and decide the present case on its merits, and conclude that the judge in the prior case would have reached the same decision from the actual facts that

he reached from an erroneous stipulation by both parties?

VII

Could the Tax Court decide a tax case arising under Section 722 of the Internal Revenue Code of 1939, as amended, without a review by "a special division of the Tax Court which shall be constituted by the presiding judge and consist of not less than three judges of the Tax Court" (Section 732 (d), Internal Revenue Code)?

VIII

Could the Tax Court, sitting as an administrative agency under a special section of the Internal Revenue Code providing a particular form of relief, which allowed no appeal from the Tax Court's decision, apply the rule of collateral estoppel and thus prevent a hearing on other causes of action for later years?

IX

Could the Circuit Court on review apply the rule of collateral estoppel after it had recognized an error in the prior case which it said "may well have" caused the Tax Court to make the erroneous finding of fact?

STATUTES AND REGULATIONS INVOLVED

The statutory provisions and regulations involved are:

(1) Title 26, U. S. Code, 1952 ed., Chapter 2, Subchapter E, Section 722 and Section 732.

(2) Internal Revenue Regulations 112.

Relevant parts of the statutes and regulations involved are printed in the Appendix beginning at page 18a of this petition.

STATEMENT OF THE CASE

The petitioner is the successor in interest of Huguet Fabrics Corporation, and the case here under review is the excess profits tax case of Huguet Fabrics Corporation (hereinafter called Huguet).

Huguet duly filed its tax returns for its successive fiscal years ended September 30, 1941, 1942, 1943, 1944, 1945, and 1946, and duly paid the amounts shown thereon to be due. These taxes included various amounts of excess profits taxes.

In computing excess profits taxes, Huguet's average base period net income, without any reconstruction under Section 722 of the Internal Revenue Code, was $20,792.93, (19 T.C. 535, at page 539), and such amount was used as the basis for calculating the excess profits taxes paid.

For each of its taxable years involved, and in due time, Huguet filed claims for relief under Section 722 of the Internal Revenue Code of 1939, as amended (Appendix 18a), claiming that its excess profits tax credit without relief under Section 722 was far too low. In filing its claims, Huguet claimed under all the provisions of Section 722.

Petitioner's claim for refund for excess profits taxes for the fiscal year ended September 30, 1941, was denied by the Commissioner of Internal Revenue. In due time, as allowed by the Internal Revenue Code (Section 732 (a)), the petitioner filed a petition with the Tax Court seeking a refund under the provisions of Section 722.

This case came on to be heard in the Tax Court on October 23-24, 1950.

In the Tax Court, the petitioner abandoned its claims to relief under subsections (b) (1), (2) and (3), of Section 722 and decided to and did rest its case on Section 722 (b) (4) (19 T.C. 535, at page 541). Section 722 (b) (4) (Appendix 20a) provides for a constructive base period net income to be used in computing excess profits taxes, and for a two-year push-back, in those instances where the character of the business was changed during the base period (1936 to 1939 for calendar year taxpayers, or in this instance, the fiscal years October 1, 1936, to September 30, 1940).

Section 722 (b) (4) and the regulations thereunder (Appendix 23a, *et seq.*) provide that either a change in a taxpayer's product or a change in the method of distribution of a taxpayer's product was such a change in the character of the business as would qualify the claimant for a constructive base period net income.

At the Tax Court hearing in October 1950 on the 1941 case, the petitioner showed that it had formerly made delicate sheer silk materials for ladies' outer garments and expensive evening dresses, and that it had enjoyed considerable prosperity in that field, but that due to changing styles, the inroads of rayon and a growing unpopularity of silk, petitioner had had to seek a new product in order to survive.

Petitioner showed that, during its base period, it employed expert help and conducted numerous experiments in the search for a new or more profitable product, and a new and more profitable method of operating. Towards the end of its base period, petitioner set out on a program to change the major part of its production to strong utility fabrics (made of the newly invented thread known as nylon), for women's under-

garments such as brassieres and girdles, and began to distribute and sell such nylon fabrics, not through jobbers as it had always sold its silk products, but directly to the manufacturers of such sturdy undergarments.

This was a new and different product and a new and different method of distribution.

At the trial table, the parties stipulated that if the point of law was decided in favor of the petitioner, the Tax Court should use as the basis of a reconstructed average base period net income one dollar a pound profit for each pound of nylon thread constructively used by petitioner. The testimony was that the poundage would be 20,000 pounds a month, or 240,000 pounds a year, making a constructive profit of $240,000 a year, subject to a formula used in such cases and known as the "Index, Commissioner's Mimeograph 5807, Series B."

The parties also filed a joint stipulation which the respondent, in good faith, had requested the petitioner to sign, and which the respondent and the petitioner both thought to be true.

Among the exhibits to this stipulation was Exhibit 6-F (Appendix 29a). Exhibit 6-F was an incomplete columnar statement which showed "Sales" for the year ended September 30, 1940 (the last year of the petitioner's base period), in the first column as $1,047,381.93; and which listed in five columns sales totalling $940,532.51 to five of the customers of the petitioner, all five of whom were jobbers and old customers of the petitioner. Sales of $106,849.42 to others were not listed or accounted for.

The Tax Court, in its first opinion (18 T.C. 605, at page 613), recognized that the petitioner had changed its business by going into the manufacture of fabrics made of nylon instead of silk, but held that the change from silk to nylon was not such a change as would qualify the petitioner to receive the benefits of Section 722 (b) (4).

The Tax Court, in its first opinion also recognized that petitioner had shown by the testimony of its general manager that the petitioner had established a new and different method of distributing its products, namely, by selling its products direct to manufacturers, rather than through jobbers, but ruled that this evidence was set at naught by Exhibit 6-F of the stipulation, which showed sales to jobbers only. The Tax Court, not realizing that the listed sales to jobbers on Exhibit 6-F was not an itemized list of *all* sales, reasoned that no sales could have been made to manufacturers if all sales were made to jobbers. The Tax Court had not noticed the difference of $106,849.42, and erroneously assumed that the sales listed to the five jobbers, if added, would reach the total sales of $1,047,381.93.

The Tax Court considered Exhibit 6-F controlling, and on the conclusion it reached from Exhibit 6-F, ruled against the petitioner, saying:

> "* * * While these stipulated facts are in conflict with the testimony of petitioner's general manager, who testified that all of petitioner's sales of nylon fabrics for the fiscal year ended September 30, 1940, were made directly to manufacturers of undergarments, the facts stipulated must prevail." (18 T.C. 605, at page 612.)

The petitioner filed with the Tax Court a timely request for a rehearing, pointing out the error made by the Tax Court in considering the stipulation. Upon considering the request for a rehearing the Tax Court realized the error it had made in misreading the stipulation and reopened the case, but without a hearing.

The Tax Court then again decided the matter against the petitioner, and again reached its decision on the basis of that same stipulation, Exhibit 6-F, pointing out that:

> "* * * While it may be possible (as the manner in which the stipulation was presented certainly tends to indicate) that the stipulation was intended to show that all sales were made to the five jobbers and that the difference between the total of these sales and the total sales listed for each month may be the result of not including in the total figures any sales adjustments, such as sales returns and allowances, *it is probably more nearly correct that the difference is in fact due to sales to other customers*, as petitioner's attorney contends. Accordingly, looking at the total sales of the five jobbers in September 1940, we find there exists between this amount ($81,719.84) and the total sales ($90,939.50) a difference of $9,219.66. However, the stipulation [Exhibit 7-G] shows that during this month there were nylon sales of $10,346.45, which by basic arithmetic would mean that $1,126.79 worth of such sales would necessarily have been made to the five named jobbers, none of whom were manufacturers of undergarments." (19 T.C. 535, at page 545.) (Italics added.)

In both its first opinion and its second opinion, the Tax Court turned the case squarely on Exhibit 6-F, and so stated:

> "The state of the record with respect to *this important* element of the alleged change is indeed

confused, and the petitioner has not met its burden of proving that during the base period it embarked upon a new and different business.

* * *

"We must conclude from the state of the record in this case that insufficient evidence was introduced to establish the existence during the base period of a qualifying change within the requirements of Section 722 of the Code." (19 T.C. 535, at pages 546, 547.) (Italics added.)

After the decision in the 1941 case had become final, and after the petitioner's claims for relief under Section 722 for subsequent years had been denied and petitioner had filed petitions with the Tax Court seeking refunds for such later years, and after those cases for later years had been set for trial before the Tax Court, the respondent, on October 19, 1953, interposed a plea of collateral estoppel. This plea was grounded on the proposition that the decision in the prior case for 1941 estopped the petitioner for all time from having its claims for a constructive average base period net income and for relief under Section 722 of the Internal Revenue Code heard and determined.

Upon respondent's motion to sever the issues and to try the sole question of collateral estoppel first, the Tax Court issued an Order (Appendix 35a) setting the case for a hearing on the sole question of collateral estoppel.

On January 9, 1956, a hearing was had before the Tax Court under this Order.

At the hearing, the petitioner proved that there was an error of $8,579.25 in Exhibit 6-F, the exhibit on

which the Tax Court had turned its decision in the prior case.

It was shown that, whereas the stipulation, Exhibit 6-F, showed, for the month of September 1940, total sales of $90,939.50 and itemized sales of $81,719.84, the correct figures were total sales of $90,939.50 and itemized sales of $73,140.59, a difference in itemized sales of $8,579.25.

The error was in the column of sales to Wm. Cohen Fabrics. Sales to Wm. Cohen Fabrics in September 1940 were listed on Exhibit 6-F as $8,579.25, whereas no sales whatever were made to Wm. Cohen Fabrics in September 1940 (R. 35*). No sales had been made to Wm. Cohen Fabrics since May 1940 (R. 35).

When this error is corrected, the reasoning on which the Tax Court turned the prior case would fall.

The Tax Court, in the prior case, did not know of this error, which was not discovered until the decision in the prior case had become final. The Tax Court had found for September 1940 sales of $90,939.50, itemized to the extent of $81,719.84 as sales to jobbers, plus nylon sales of $10,346.45, making a total of $92,066.29,

> "which by basic arithmetic would mean that $1,126.79 worth of such sales would necessarily have been made to the five named jobbers, none of whom were manufacturers." (19 T.C. 535, at page 546.)

On the corrected figures, there would be sales of $90,939.50, itemized to the extent of $73,140.59 as sales to jobbers, plus nylon sales of $10,346.45, making a

* Record references are to certified transcript of record and proceedings in the United States Court of Appeals for the Second Circuit, Vol. I.

total of $83,487.04*, "which by basic arithmetic" would mean that *none* of such sales would have been made to the five named jobbers. Another $7,452.46 of sales for the month of September 1940 would have to be accounted for as sales to other purchasers before there would be such an overlap as would "by basic arithmetic" suggest that any nylon sales were made to jobbers.

The petitioner also proved by its books of account that it made nylon sales in the year ended September 30, 1940, of $16,458.01, and showed to whom such sales were made** (R. 32

---

* Correcting the stipulation, Exhibit 6-F, the month of September 1940 shows:

Sales		$90,939.50
Stern & Stern	$43,898.17	
Goldenbro Fabrics	28,118.91	
Kimball, Inc.	500.72	
Mann & Delaney	622.79	
Wm. Cohen	0	
Total Sales Accounted for	$73,140.59	
Add nylon	10,346.45	
Total Sales to Five Named Jobbers plus Total Sales of Nyon		$83,487.04
This leaves:		
Sales not made to any of the Five Named Jobbers		$ 7,452.46

** Fay Miss Brassiere Co. named later changed to Bali Brassiere Co. $15,979.68
Endurette Corp. of America 24.65
Warner Brothers 51.57
Julius Kayser & Co. 354.94
National Ass'n of Dyers & Cleaners 14.97
Stern & Stern Textile Importers, Inc. 1.40
E. I. duPont deNemours Co. 30.80
$16,458.01

The parties stipulated at the hearing (Appendix 30a) that the sales were made to:

(1) Fay Miss, later known as Bali Brassiere Co.; Julius Kayser & Co., Endurette Corporation of America, and Warner Brothers, all of whom were manufacturers; and

(2) As samples not for resale, to E. I. duPont de Nemours, National Association of Dyers and Cleaners, Stern & Stern Textiles, Inc. These latter sales were in a total amount of only $47.17.

After hearing this case under the Order confining the matter to the sole question of collateral estoppel, and without having allowed the petitioner to be heard on the merits, the Tax Court, acting through one judge, and without a review by "a special division of the Tax Court which shall be constituted by the presiding judge and consist of not less than three judges of the Tax Court," as required by law,* considered this case on the merits, and despite the order to hear only the collateral estoppel question, decided the case on the merits, stating:

> "ORDERED and DECIDED: That the petitioner is not entitled to relief for the year ended September 30, 1942 [1943, 1944, 1945, and 1946], under the provisions of Section 722, Internal Revenue Code." (Appendix 9a:)

The petitioner appealed to the United States Court of Appeals for the Second Circuit, under the provisions of Sections 7482 and 7483 of the Internal Revenue Code of 1954, and Section 732(c) of the Internal Revenue Code of 1939. The Second Circuit affirmed the decision of the Tax Court.

---

*Section 732 (d), Internal Revenue Code (Appendix 22a).

REASONS RELIED ON FOR THE ALLOWANCE OF THE WRIT OF CERTIORARI

Summary

I. The decision below is contrary to the decisions of this Court.

(a) Mutual mistake of fact

(b) Change of legal climate.

II. There is a conflict between the Circuits on the question of collateral estoppel in tax cases.

III. The Tax Court, under the special statute authorizing it to review refund claims for relief under Section 722 of the Internal Revenue Code, was required to have its decisions reviewed by a special division of its members consisting of three or more of its judges appointed by its presiding judge. In this case no such review was had, and a motion seeking such a review was summarily denied.

IV. The Tax Court, under the special statute authorizing it to review refund claims for relief under Section 722 of the Internal Revenue Code, did not have authority to apply the rule of collateral estoppel. Its sole authority was to hear the claims, have them reviewed by a special committee of its judges, appointed by its presiding judge, and dispose of them.

V. The respondent is basing a plea of collateral estoppel upon his own mistake and ought not to be allowed to do so.

VI. The Second Circuit departed from the issues before it in sustaining the Tax Court.

I. THE DECISION BELOW IS CONTRARY TO THE DECISIONS OF THIS COURT

(a) Mutual Mistake of Fact

This is a tax case in which the Courts below have applied the rule of collateral estoppel. The prior case, which is the basis for the plea of collateral estoppel, involved another and different taxable year from those involved in the present case. In that prior case, there was a mutual mistake of fact on which that prior case turned. Now the petitioner has been held to be estopped to try its present case and to present the true facts. The question really is this:

> Must a mutual mistake of fact in a tax case for one year go on and on year after year uncorrected, to the great detriment of the petitioner, or can the mistake be corrected and the true facts presented in the tax cases for later years?

It is respectfully submitted that the question presented by this case was answered by the *Sunnen* case (*Commissioner* v. *Sunnen*, 333 U.S. 591, 68 S. Ct. 715), in the petitioner's favor.

The case at issue presents the very situation which was before this honorable Court in the *Sunnen* case, and in that case this Court required that:

> "collateral estoppel be used with its limitations carefully in mind so as to avoid injustice." (*Commissioner* v. *Sunnen*, supra.)

Every word of the *Sunnen* case applies with peculiar force to the case at bar:

> "(7) But collateral estoppel is a doctrine capable of being applied so as to avoid an undue disparity in the impact of income tax liability. A

taxpayer may secure a judicial determination of a particular tax matter, a matter which may recur without substantial variation for some years thereafter. But a subsequent modification of the significant facts or a change or development in the controlling legal principles may make that determination obsolete or erroneous, at least for future purposes. If such a determination is then perpetuated each succeeding year as to the taxpayer involved in the original litigation, he is accorded a tax treatment different from that given to other taxpayers of the same class. As a result, there are inequalities in the administration of the revenue laws, discriminatory distinctions in tax liability, and a fertile basis for litigious confusion. Compare United States v. Stone & Downer Co., 274 U.S. 225, 235, 236, 47 S. Ct. 616, 71 L. Ed. 1013. Such consequences, however, are neither necessitated nor justified by the principle of collateral estoppel. That principle is designed to prevent repetitious lawsuits over matters which have once been decided and which have remained substantially static, factually and legally. It is not meant to create vested rights in decisions that have become obsolete or erroneous with time, thereby causing inequities among taxpayers."

Just as in the *Sunnen* case, the present case involves different taxable years than that involved in the prior case upon which the plea of collateral estoppel was based.

In the present case, there has been more than a "modification of the significant facts", there has been proof of a mutual mistake of fact in the prior case.

In the case at issue, the mutual mistake has been shown. The Tax Court in the prior case, before the mistake was discovered, in two opinions turned the

prior case on the effect of the joint stipulation which later proved to have been erroneous.

The Tax Court in the case now at issue here presumed to say that the Tax Court in the prior case would have reached the same conclusion on a correct stipulation that it reached on the false and misleading stipulation. But who can say as to that? The question is "for the jury," and the "jury" in the prior case was one judge and a committee of three or more reviewing judges appointed by the presiding judge of the Tax Court. Only a trial in the present case can solve this important question. (See Section II.)

Coming now to the decision of the Second Circuit in the case here at issue, we find that Court saying that if the mistake was material, it would hold for the petitioner. Said the Second Circuit:

> "* * * Indeed, if the error was of such a character that the substitution of an accurate statement of the facts would require a finding in this case that 'the taxpayer either during or immediately prior to the base period, commenced business or changed the character of the business and the average base period net income does not reflect the normal operation for the entire base period' (Section 722 [b]), we would favor a reversal of the decision of the Tax Court." (Appendix 7a.)

After saying that, the Second Circuit recognized the materiality of the mistake, for it said:

> "* * * *Because of this error*, the court may well have found that instead of selling its nylon products directly to manufacturers as claimed, taxpayer still used jobbers during the crucial period." (Appendix 8a.) (Italics added.)

After finding that there was a mutual mistake of fact in the prior case, and after recognizing that it was material, the Second Circuit should have held for the petitioner. Instead of holding for the petitioner, the Second Circuit digressed into other matters not before it for review, and indeed even into the merits of the prior case, and decided that petitioner was collaterally estopped to try its case. (The Second Circuit's digression is discussed below herein, at Section VI.)

Petitioner believes that the present case falls within that area in which this honorable Court has said that the doctrine of collateral estoppel is to be used only "with its limitations carefully in mind so as to avoid injustice."

If the present case does not fall within that area outlined in the *Sunnen* case, then it is a matter of national importance that this honorable Court should undertake to clarify and define the law regarding collateral estoppel in tax cases involving mutual mistake of fact.

(b) Change in Legal Climate

It is respectfully urged that there has been a complete change in the legal climate in the area of Section 722 relief since the decision of the prior case in the winter of 1952.

In this case there was an admitted change in this company's product from silk to nylon. Upon a two-year push-back rule, that change would have been a very great change indeed. It would certainly have been so extensive a change and so complete a change as to qualify this petitioner under Section 722 (b) (4)

if the character of the change itself was a qualifying change under Section 722 (b) (4).

In the prior case, the Tax Court ruled that a change from silk to nylon was not such a change as would qualify the petitioner under Section 722 (b) (4). Said the Tax Court:

> "We have found as a fact that the petitioner commenced the manufacture and sale of fabrics manufactured from nylon in the last quarter of its fiscal period ended September 30, 1940. This was, of course, a change; however, not every change is sufficient to satisfy the requirements of the statute. * * * " (19 T. C. 535, at page 542.)

Since the decision in the prior case, however, the climate has changed, and the Tax Court now recognizes that a change from silk to nylon—standing alone—is a "revolutionary change," and that that change alone and of itself, is a qualifying factor under Section 722 (b) (4). Said the Tax Court in *Davenport Hosiery Mills, Inc.*, 28 T. C. 201 (April 30, 1957):

> "* * * We think the facts show that the change to nylon was not only substantial but was revolutionary. * * * " (28 T. C. 201, at page 215.)

The change from silk to nylon under the prior decision in petitioner's case in December 1952 was held to be no change at all. The change from silk to nylon was a "revolutionary change" in April 1957, and it is submitted that this petitioner in 1959 is entitled to enjoy the more temperate climate.

Surely each separate Section 722 tax case before the Tax Court is not settled whimsically regardless of fact and law, favoring some and punishing others.

It is far more likely that the Tax Court with the passing of time has come to realize that manufacturing nylon is indeed a great change from manufacturing silks.

Surely if, under the present climate, a change from manufacturing silk stockings to manufacturing nylon stockings is a revolutionary change qualifying under Section 722 (b) (4) (*Davenport Hosiery Mills, Inc., supra*), a change from manufacturing silk sheers for fine evening gowns to manufacturing plain strong nylon goods for brassieres and girdles is an even more complete change.

II. THERE IS A CONFLICT BETWEEN THE CIRCUITS IN THE MATTER INVOLVED

In the case of *Parker* v. *Westover*, 221 F. (2d) 603, in the United States Court of Appeals for the Ninth Circuit, a tax deficiency was assessed against the parents in an alleged family partnership (parents and minor children) case. The parents paid the tax and sued the Collector to recover. The Collector won.

Subsequently, the parents entered into an agreement with the State court concerning the handling of the alleged partnership's funds in connection with tax litigation.

Thereafter, tax deficiencies for later years were assessed against and collected from the parents. The parents again sued to recover.

The Collector pleaded collateral estoppel.

On the thin thread of the State Court proceedings concerning the finances of the partnership, the rule of collateral estoppel was held not to apply.

The Ninth Circuit, in the *Parker* case, said:

> "* * * The possibility of a different verdict because of the introduction of evidentiary facts different from those before a court and jury in a prior case is sufficient to surmount the danger of collateral estoppel in an income tax situation. The new evidence need not positively change the character of the case. It need only change the complexion of the significant facts presented to the jury. The settlement of an evidentiary fact question, once in dispute before a jury, which has a significant bearing on the case, lifts the bar of collateral estoppel. In a new trial, both the taxpayer and the Government will be in a position to argue to a jury the effect of this new evidentiary fact upon the original partnership agreement."

In a Section 722 Tax Court case, the "jury" might be said to consist of the trial judge, or judges, and a committee of three or more judges of the Tax Court, appointed by the presiding judge.

Once a mistake of fact had been found in the case at bar, the Second Circuit should have reversed the Tax Court and remanded the case to the "Tax Court-jury".

Since the Ninth Circuit takes one view of collateral estoppel in tax cases, and the Second Circuit takes another view, it is important that this honorable Court should resolve the conflict between the circuits by granting a writ of certiorari here.

III. THE TAX COURT, UNDER THE SPECIAL STATUTE AUTHORIZING IT TO REVIEW REFUND CLAIMS FOR RELIEF UNDER SECTION 722 OF THE INTERNAL REVENUE CODE, WAS REQUIRED TO HAVE ITS DECISION REVIEWED BY A SPECIAL DIVISION OF ITS MEMBERS CONSISTING OF THREE OR MORE OF ITS JUDGES APPOINTED BY ITS PRESIDING JUDGE. IN THIS CASE NO SUCH REVIEW WAS HAD, AND A MOTION SEEKING SUCH A REVIEW WAS SUMMARILY DENIED

The final determination of tax refunds arising out of claims for relief under Section 722 of the Internal Revenue Code was entrusted to the Tax Court of the United States absolutely, and without a review (Section 732 (c) and (d), Appendix 21a-22a).

Before the enactment of Section 732, the Tax Court had no jurisdiction over refund cases. Its authority to hear refund cases under Section 722 rests solely on Section 732 of the Internal Revenue Code (Appendix 21a-22a).

In order to protect the taxpayer's rights against capricious, whimsical or prejudicial action by any one judge of that Court, the statute wisely and specifically provided and required that no one judge of that Court could determine the rights of any taxpayer under Section 722. It provided that a special committee consisting of not less than three judges of the Tax Court should be appointed by the presiding judge to review all decisions on *any* question whatsoever arising under Section 722.

In the case here at bar, the decision that this petitioner was not entitled to relief under Section 722 was made by one and only one judge of the Tax Court, and a review by a special committee of not less than three judges was not afforded.

The petitioner duly filed a motion asking for such a review (Appendix 31a), and it was summarily denied.

It is respectfully submitted that where an administrative body is designated by statute to do a certain thing in a specified way, it must conform to the mandate of the statute creating its power and designating its duties. The Tax Court, in acting through a single judge and in purporting to decide this claim for a great amount of money against this petitioner without following the statute under which it was empowered to hear this claim, exceeded its authority and took property from this petitioner without due process of law.

The petitioner, in appealing to the Tax Court for its refund, was assured by Congress a degree of fair play and a serious consideration of its rights that it could not expect from one lone judge and that it did not get. Congress promised the petitioner that its claim would not only be heard, but that the decision in its case would be reviewed by a committee of not less than three judges selected by the presiding judge of the Tax Court. This promise was not kept. The action of the one judge of the Tax Court who decided this case on its merits without a hearing on its merits was not reviewed by a committee of three judges appointed by the presiding judge of the Tax Court, nor was it reviewed at all. The petitioner was entitled to such a review as a matter of law.

Congress well knew the dangers in delegating to administrative bodies the powers of the courts, and wisely made the provisions it did in Section 732 to prevent one single administrator from handling such important matters alone, without review. The provision for a review was necessary not only to insure some measure of justice, but to protect the Federal revenues. The review was mandatory.

It is respectfully submitted that when Congress went so far as to entrust the final decisions in such important

matters concerning the Federal revenue to an administrative body, without the right of an appeal to any court, instead of to a court, it expected the administrative body, at the least, to go through the form of having the review which Congress instructed it to afford.

It is submitted that the failure to afford the prescribed review was a fatal error and for this reason, if for no other reason, this case should be remanded.

IV. THE TAX COURT, UNDER THE SPECIAL STATUTE AUTHORIZING IT TO REVIEW REFUND CLAIMS UNDER SECTION 722 OF THE INTERNAL REVENUE CODE, DID NOT HAVE AUTHORITY TO APPLY THE RULE OF COLLATERAL ESTOPPEL

It is respectfully urged that the Tax Court of the United States is a Federal administrative body having no rights or powers beyond those given to it by statute. The statute creating the Tax Court (then called the Board of Tax Appeals) designated it "an independent agency in the executive branch of the government" (53 Stats. 158, 26 U.S.C.A. § 1100), and it was so held by this honorable Court in *Old Colony Trust Co.* v. *Commissioner*, 279 U. S. 716, 49 S. Ct. 499.

The authority of the Tax Court was extended to cover claims for refund under Section 722 of the Internal Revenue Code by a special statute (Section 732, Appendix 21a) which set out the rights and duties of the Tax Court in such cases, and made its decisions final.

In the present case, instead of hearing petitions on the claims now before this Court as required by law, the Tax Court refused to hear them, and acting under its own Order to confine a hearing on the petitions to the sole question of collateral estoppel, decided the case purportedly on the merits, without ever having heard the merits. (The very manner of the decision was in

violation of the express provisions of the statute. That question is discussed above in Section III.)

It is respectfully urged that an administrative body, such as the Tax Court of the United States, when given certain jurisdiction by statute to hear and decide certain claims under a specified procedure which, if followed, allowed no appeal from its decisions, is required to hear such claims if properly presented to it, and to follow the indicated procedure.

In such cases there is no reason for a plea of collateral estoppel, for no question of repose is involved—a quick hearing, an immediate decision, and all is over. If the same facts are offered as were offered in a prior case, the Tax Court can make quick work of them, and no appeal will lie. If different facts or different legal principles or change in legal climate are shown in the new case, the new case must be decided on its merits, and no appeal is allowed. In either event, a few hours would dispose of the matter, once and for all.

Not only is there no need for the plea of collateral estoppel but that remedy of the law Courts is not and should not be available to administrative bodies. Administrative bodies have but to do what the statute directed them to do, and the matter is done with, once and for all.

The present case would have been finished, one way or another, about five years ago if the Tax Court had only done as the statute instructed it to do.

The Tax Court itself (then the Board of Tax Appeals), in a well considered opinion outlined its own measure of its powers in a situation comparable to the one here presented. In *Appeal of Union Metal Manufacturing Co.*, 4 B.T.A. 287, at page 288, it said:

"The argument as to the force of the doctrine of *res judicata* is deserving of the most careful consideration. It is an ancient doctrine and has been applied to judicial proceedings with unquestionably salutary effect. That it is a wise rule in many cases cannot be questioned. But it is in its nature a doctrine of expediency, devised in the belief that the public interest was better served by prohibiting repetitious litigation and assuming the correctness of a decision once rendered than by persisting in the search for truth and accuracy in each case. It has no absolute sanction in all circumstances and, if it does not fit the system in which it is invoked, its limitations may not be ignored.

"This Board is a new creature with a special place in the governmental system of settling disputes. With a function in all respects judicial as to such matters as come within the confines of its powers, it is, nevertheless, nominally outside the judicial system. This was especially so under the Revenue Act of 1924, in effect when this hearing was had. Designated by statute as a 'board' and as 'an independent agency in the executive branch of the government' with a duty to 'hear and determine appeals,' through a membership appointed 'solely on the grounds of fitness to perform the duties of the office,' it appeared to be the final arbiter of all appeals within its limited jurisdiction, for there was no review provided of its determinations. All its cases involved disputes between the taxpayer and the government as to income, profits, estate, and the moribund giff tax. The government was always a defendant. The questions were closely related and an error either in fact or law as to one taxpayer, or as to one year of tax, could affect the tax liability of many others so that it might project itself in an ever-growing circle to bring about great injustice and distort the public revenue. Thus

uniformity of precept, which has always been regarded as a desirable achievement, could become an instrument of destruction of justice and defeat its own principal purpose. If the perpetuation of error with such possible results can be avoided without at the same time involving the system in confusion and inefficiency, no adherence to a doctrine should be permitted to prevent its avoidance. And certainly this must be so at least until it is clearly demonstrated by experience of this special tribunal that the doctrine is indispensible. Its necessity should not be assumed while the Board is still at the threshold of its career.

"* * * While it is most expedient that there should be but one trial before the Board on a single issue and that the parties should abide the judgment in each case, this can not support a system which would make possible the projection of errors into other proceedings."

V. THE RESPONDENT IS BASING A PLEA OF COLLATERAL ESTOPPEL ON HIS OWN MISTAKE AND OUGHT NOT TO BE ALLOWED TO DO SO

The prior case turned upon a mutual mistake of fact in a stipulation.

The incorrect stipulation was asked for by the respondent, was agreed to by the petitioner, and was offered as a joint stipulation of both parties. Both parties thought the facts were correct.

The respondent now relies, as a grounds for collateral estoppel, on a mistake to which he was a party.

The foregoing temperate suggestion in no way reflects the petitioner's feeling in this matter. It is submitted that the United States (and any of its agencies and servants) when it comes into court should come in like a man, carrying the rights and duties of a man.

The rule that one should not take advantage of his own wrong, the rule that one who seeks equity shall do equity, and the rule that one must come into equity with clean hands all apply to the United States (and its servants and agents), once it is in court.

It seems to the petitioner that this situation applies with added force in tax cases where the belaboured taxpayer finds himself at such a great disadvantage in having always to carry the burden of proof. It should apply with even greater force in a Section 722 tax case where Congress admonished the taxing authorities to conduct an intelligent and sympathetic administration. (H. Report No. 146, 77th Congress, 1st Session, 1941 C. B. 550-551)

Surely the United States ought to be above collecting taxes that are not owed it, or keeping tax money that belongs to taxpayers, through the ignoble device of taking advantage of mistakes it induced and helped to make.

Indeed, the United States should be above taking advantage of a mistake no matter who made the mistake.

VI. THE SECOND CIRCUIT DEPARTED FROM THE ISSUES BEFORE IT IN SUSTAINING THE TAX COURT

After stating that it would hold for the petitioner if the mistake was material, and then recognizing the materiality of the mistake (which matters have been fully discussed by petitioner in Section I of this petition), the Second Circuit, instead of deciding for the petitioner, reviewed the prior case and concluded:

> "* * * the change in selling method was only one of several alternate grounds for the conclusion that base period net income had not been shown to be 'abnormal.'" (Appendix 8a.)

While the Second Circuit did not name the "alternate grounds" for finding that petitioner had not proved its base period net income abnormal, the Second Circuit did list four paraphrased points which it appears to have selected from the Tax Court opinion in the prior case and which it apparently considered important. These were:

> "(1) there was insufficient proof to show a change in the character of taxpayer's business either in the products manufactured or in the method of sales;
>
> "(2) there was insufficient proof that the asserted change resulted in lower costs;
>
> "(3) there was insufficient proof that any such alleged lower costs were not passed on to the taxpayer's customers; and
>
> "(4) the evidence did not indicate any temporary circumstances which depressed business during the base period." (Appendix 8a.)

With regard to the Second Circuit's first point above, petitioner is unable to find any foundation for the Second Circuit's conclusion that "there was insufficient proof to show a change in the character of taxpayer's business * * * in the products manufactured." The Tax Court said at page 542 of its opinion in the prior case (19 T. C. 535) that it *did* find a change in petitioner's product, but dismissed it as not being sufficient to satisfy the requirements of the statute. Petitioner has discussd this question under Section I (b), Change in Legal Climate, above, for the Tax Court found that such change *was* sufficient in the case *Davenport Hosiery Mills, Inc., supra.*

As to the other insufficiency of proof mentioned by the Second Circuit in its first point, proof of change

in the method of sales: the "insufficiency" would be cured on a trial of the present case, for it was this insufficiency which the Tax Court found resulted from the confusion growing out of the mutual mistake of fact in the stipulation. This question has been discussed by petitioner in Section I (a), Mutual Mistake of Fact, the principal question before the Second Circuit.

That leaves the last three points which might be described as "alternate grounds."

Point (2), namely "reduced costs": A showing of reduced costs is not a necessary element in a Section 722 (b) (4) case. In a Section 722 (b) (4) case the basic element is not *cost*. The basic elements are *change*, and then *profits*. Proof of reduced costs, however, and of increased profits was offered at the hearing and was not contradicted. The parties stipulated in the prior case that the *profit* in the changed business would be one-dollar a pound. (This is discussed below.)

Point (3) above, namely the "passing on of alleged reduced costs to customers"; Since costs are not a ruling factor, it is assumed that the Second Circuit meant "profits." There is no presumption of law that a company that seeks new outlets and new products in order to make a profit will give those profits away to the customers. If there is any presumption of law in such a case, it is that a person who makes a profit will endeavor to keep it. There is no rule or regulation under the tax law that requires proof of "no passing on" in order to qualify under Section 722 (b) (4). The idea of "passing on" was, in fact, an invention of the Tax Court in this case. Petitioner has been unable to find any reference to such a requirement of proof by the Tax Court in any other Section 722 (b) (4) case.

The facts are that the parties (petitioner and respondent together) at the trial table disposed of this whole matter by stipulating that the Tax Court should use, in making its reconstruction calculation of the changed business, the figure of one dollar a pound profit.

It is submitted that the Tax Court was bound by this stipulation, and under this stipulation no reduced selling price could reduce the petitioner's profit below one dollar a pound, nor could any lower or higher costs change that figure.

The Tax Court did not like that stipulation so it read it out of the record by the following remarkable statement found in its second opinion in the prior case:

> "* * * In this respect what the parties may have stipulated concerning reconstruction is neither competent nor sufficient to establish such facts." (19 T.C. 535, at page 547.)

But, fortunately, the matter was fully covered in the trial of the prior case, although the Tax Court closed its eyes to that fact, and misled the Second Circuit into doing the same thing.

The record in the trial of the prior case shows that the petitioner's general manager, who was a trained accountant, testified to the reconstruction of the net income of the petitioner's business under the two-year push-back rule laid down in Section 722 (b) (4). He started with a computation of receipts from sales, and went on to net profit. He showed a reconstructed basis of nylon consumed at 20,000 pounds a month, and arrived at a constructive net profit to the petitioner of

$286,406.04 per year. (Tr. 52-58, Hearing of October 23, 1950)

The respondent also put on an expert witness to show his reconstruction of petitioner's profit. After this testimony, the respondent and the petitioner read into the record an agreement (Appendix 30a) that the Tax Court should use the basis of one dollar a pound of nylon yarn constructively consumed as representing the profit of the petitioner to be used in the reconstruction calculation. Under this stipulation, the petitioner would have realized one dollar a pound of profit after any passing on of savings and after all costs and disbursements of every sort.

Coming now to the Second Circuit's point (4) concerning lack of proof of "temporary circumstances which depressed business during the base period": Relief under Section 722 (b) (4) of the Internal Revenue Code did not rest upon proof of a temporary depression during the base period. The Tax Court itself attributed that test to Section 722 (b) (2), a claim which petitioner had abandoned, when the Tax Court said:

> "With respect to petitioner's claim under the factors contained in paragraphs (1) through (3) and paragraph (5) of section 722 (b), * * *
>
> "Such evidence does not prove that there were * * * any temporary circumstances unusual in the case of the petitioner which depressed its business as required by paragraph (2) of that section * * *." (19 T.C. 535, at page 547.)

Section 722 (b) (4) relief rested upon a change in product or a change in method of selling, coupled with the application of the two-year push-back rule.

There is nothing in the opinion of the Second Circuit to indicate that that Court was aware of the two-year push-back rule.

The qualifications and procedure for relief under subsection (b) (4) of Section 722 are separate and distinct from the qualifications and procedure for relief under the other subsections of Section 722 (b). The respondent in his Bulletin has discussed this and has pointed out the differences with great clarity. The applicable parts of respondent's Bulletin are set out in the Appendix hereto at pages 25a *et seq.*

It is well settled that a taxpayer has to qualify under only one subsection of Section 722 (b). If it qualifies under one subsection, it cannot be required to qualify under any alternative one, nor will it be allowed to qualify under alternative subsections: *Rand Beverage Co.*, 13 T.C. 275, at page 287; *Fishbeck Awning Co.*, 19 T.C. 773, at page 781; *Hemenway-Johnson Furniture Co.*, 22 T.C. 43, at page 56.

The petitioner strongly urges that the three reasons advanced by the Second Circuit as alternate grounds for sustaining the Tax Court had no application to the issues before the Second Circuit, and petitioner feels that the Second Circuit should have reversed the Tax Court on the basis of the mistake of fact, the real issue before the Second Circuit.

There remains one important feature of this case which may have misled the Second Circuit. In the present case when the Tax Court heard proof establishing that there was a mutual mistake of fact in the prior case, the Tax Court attempted to belittle the mistake in order to sustain its prior decision. In so doing, it referred to the proof as "but a bit of evidence," and refused to disturb its prior conclusion of "not proved."

In that connection, there appears to have grown up in the minds of the respondent and the Tax Court a theory in regard to tax cases that a decision stating that a case was "not proved" is a far more damning conclusion than a decision that a case was disproved. Even if this be a sound theory, petitioner urges that it has no application in collateral estoppel cases.

There is a tendency to consider "not proved" as a sort of irrefutable ultimate fact completely disassociated from the items of evidence upon which it was based.

As a result, the theory seems to be that no mutual mistake or error that contributed to or that created the ultimate fact of "not proved" can be shown so as to disturb the ultimate fact based upon it.

The theory seems to be that the ultimate fact stands even after the "facts" on which it was based are refuted.

Under that theory, a material mutual mistake of fact upon which the prior case turned becomes but a "bit of evidence," in the eyes of the administrative agency that found the ultimate fact of "not proved."

The petitioner here claimed a change in business in two respects. One was a change in product from silk to nylon; the other was a change in method of distribution, from selling silk to jobbers to selling nylon to manufacturers.

The Tax Court here ruled out the change from manufacturing silk sheers to manufacturing sturdy nylons, stating that that was not a sufficient change to qualify under Section 722 (b) (4).

The Tax Court here admitted that a change in selling methods was a recognized change which would qualify

under Section 722 (b) (4); but through a mutual mistake of fact in the prior case a doubt was cast on the fact as to whether or not there was a change in selling methods. This doubt was removed by correcting the mistake.

Unfortunately, in the prior case, the Tax Court did not know of the mutual mistake of fact and, because of the confusion caused by the mutual mistake in the stipulation reached a decision of "not proved."

The ultimate fact of "not proved," according to the Tax Court, must stand in spite of disposing of the very "fact" on which it rests.

It is submitted that such a position is unsound and leads to gross injustice if applied to collateral estoppel cases.

CONCLUSION

The petitioner respectfully prays that the writ of certiorari be granted for the reasons above given.

Respectfully submitted,

HOWE P. COCHRAN
421 New Jersey Avenue, S. E.
Washington 3, D. C.
Attorney for Petitioner

Of Counsel:

MARGARET F. LUERS
BETTY COCHRAN STOCKVIS

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1958

No.

STERN & STERN TEXTILES, INC., (Successor in Interest to HUGUET FABRICS CORPORATION), *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE.

Order Extending Time to File Petition for Writ of Certiorari

UPON CONSIDERATION of the application of counsel for petitioner(s),

IT IS ORDERED that the time for filing petition for writ of certiorari in the above-entitled cause be, and the same is hereby, extended to and including July 21, 1959.

(s) JOHN M. HARLAN
Associate Justice of the Supreme Court of the United States.

Dated this 15th
day of June, 1959.

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

STERN & STERN TEXTILES, INC., Successor in Interest to HUGUET FABRICS CORPORATION, *Petitioner on Review,*

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent on Review.

Petition for Rehearing

Howe P. Cochran, Washington 3, D. C., (Margaret F. Luers and Betty Cochran Stockvis, of Counsel, on the Petition) for petitioner.

"Petition for Rehearing denied."

/s/ THOMAS W. SWAN
/s/ HAROLD R. MEDINA
/s/ STERRY R. WATERMAN

March 23, 1959

UNITED STATES COURT OF APPEALS
SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the second day of February, one thousand nine hundred and fifty-nine.

Present:

HON. THOMAS W. SWAN,
HON. HAROLD R. MEDINA,
HON. STERRY R. WATERMAN,
Circuit Judges

STERN & STERN TEXTILES, INC., ETC., *Petitioner*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

Appeals from The Tax Court of the United States

This cause came on to be heard on the transcript of record from The Tax Court of the United States, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the order of said The Tax Court of the United States be and it hereby is affirmed.

A. DANIEL FUSARO
Clerk

263 F. (2d) 538

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

Nos. 5-6-7-8—October Term, 1958

(Argued December 4, 1958 Decided February 2, 1959.)

Docket Nos. 24542-3-4-5

STERN & STERN TEXTILES, INC. (Successor in Interest to Huguet Fabrics Corporation), *Petitioners*,

—v.—

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

Before:

SWAN, MEDINA and WATERMAN, *Circuit Judges*.

The taxpayer seeks review of a decision of the Tax Court of the United States in four consolidated proceedings involving its fiscal years ended September 30, 1942 through 1946. Affirmed.

HOWE P. COCHRAN, Washington, D. C., *Attorney for Petitioner*, Margaret F. Luers and Betty Cochran Stockvis of Counsel.

CHARLES K. RICE, Assistant Attorney General, Lee A. Jackson and Harry Marselli, Attorneys, Department of Justice, Washington, D. C., *for Respondent*.

SWAN, *Circuit Judge*:

The petitioner seeks review of a decision of the Tax Court, reported in 26 T.C. 1000, holding that the doctrine

of collateral estoppel precludes the taxpayer from litigating its claim to relief under § 722(b) of the 1939 Code, as amended, 26 U. S. C. A. § 722(b), for its five fiscal years ending September 30, 1942 through 1946 inclusive.

Before reaching the merits of the appeal it is necessary to consider the Commissioner's contention that this court lacks jurisdiction to review the Tax Court's decision. The contention is based on § 732(c), 26 U. S. C. 1952 ed. § 733, set forth in the margin.[1] However, the precise point was decided by this court adversely to the Commissioner in *George Kemp Real Estate Co.* v. *Commissioner*, 2 Cir. 205 F. 2d 236, cert. den. 346 U. S. 876, which held that since the Tax Court based its decision on the doctrine of collateral estoppel we have jurisdiction to review despite the provisions of § 732(c). The *Kemp* case was not mentioned in *Crowell-Collier Pub. Co.* v. *Commissioner*, 2 Cir. 259 F. 2d 860, and we see nothing in the *Crowell-Collier* opinion to indicate any departure from or weakening of it. If, as the Commission asserts, decisions in other circuits are in conflicting with it, an authoritative ruling can probably be obtained by certiorari. In the meantime we shall continue to adhere to the *Kemp* decision.

We turn now to the merits of the appeal. The Tax Court's decision of collateral estoppel is based on its prior decision involving the taxable year ended September 30, 1941. The suit involving that year was brought by Huguet Fabries Corporation, the predecessor in interest to the present petitioner, and relief was claimed under § 722(b), the same section under which relief is now claimed for the subsequent years. Relief was denied. *Huguet Fabrics Cor-*

[1] "(c) *Finality of Determination.*—If in the determination of the tax liability under this subchapter the determination of any question is necessary solely by reason of section 711(b)(1)(H), (I), (J) or (K), section 721, or section 722, the determination of such question shall not be reviewed or redetermined by any court or agency except the Tax Court."

poration, 19 T. C. 535. It is conceded by appellant that in both cases the issue was the same, namely, whether a change in 1940 in the taxpayer's method of selling its products was sufficient to warrant the conclusion that taxpayer so modified the character of its business during the base period that its average base period net income was not a fair standard for the application of excess profits taxes. Nor is it denied that the principle of collateral estoppel is applicable if there has been no change in the controlling facts.[2] The appellant contends, however, that the controlling facts have not remained static and unchanged. It argues that the facts in the case respecting the latter years are materially different from those of the 1941 case, because the prior decision "turned" on a mutual mistake of fact, introduced by stipulation, and proved in the later case to have been erroneous. It maintains that except for this error in the stipulation relief would have been granted in the 1941 case. This contention was carefully considered by the Tax Court. It held that the "bit of evidence" introduced by the prior stipulation, assuming it to have been wrong, would not have produced a different result in the prior case. It analyzed the prior record and opinion and concluded that § 722 relief was denied in the 1941 case because petitioner had not introduced sufficient evidence that it had undergone a qualifying change in the character of its business. We also have ex-

---

[2] The only case cited in appellant's brief is *Commissioner* v. *Sunnen*, 333 U. S. 591, 599, where the court said: "That principle is designed to prevent repetitious lawsuits over matters which have once been decided and which have remained substantially static, factually and legally. It is not meant to create vested rights in decisions that have become obsolete or erroneous with time, thereby causing inequities among taxpayers.

"And so where two cases involve income taxes in different taxable years, collateral estoppel must be used with its limitations carefully in mind so as to avoid injustice. It must be confined to situations where the matter raised in the second suit is identical in all respects with that decided in the first proceeding and where the controlling facts and applicable legal rules remain unchanged."

amined the *Huguet Fabrics* opinion reported in 19 T.C. 535 and have reached the same conclusion. At page 546, the opinion stated:

> "* * * and the petitioner has not met its burden of proving that during the base period it embarked upon a new and different business. * * *
>
> From the state of the record before us we cannot make a finding that the petitioner embarked upon a new business and adopted new selling methods with respect to this business, nor that any such enterprise was separate and apart from its silk and rayon business."

And at page 547, the court said:

> "We must conclude from the state of the record in this case that insufficient evidence was introduced to establish the existence during the base period of a qualifying change within the requirements of section 722 of the Code. * * * we hold that the petitioner has not shown the existence of any of the factors enumerated in paragraph 4 of section 722(b)."

The same arguments with respect to the claimed error were presented to the Tax Court and are adequately discussed in its opinion. We see no necessity of discussing them again. Indeed, if the error was of such a character that the substitution of an accurate statement of the facts would require a finding in this case that "the taxpayer either during or immediately prior to the base period, commenced business or changed the character of the business and the average base period net income does not reflect the normal operation for the entire base period of the business" (Section 722[b]), we would favor a reversal of the decision of the Tax Court. But the position of the Commissioner here rests upon a much more substantial foundation. The

mistake, if there was one, was purely incidental and of no consequence.

In the inital case relating to the taxpayer's liability for the fiscal year ending September 30, 1941, the basic question was whether under § 722(b) the average base period net income was an adequate standard of normal earnings. The Tax Court then held that the taxpayer had not demonstrated the inadequacy and unfairness of the base period net income because: (1) there was insufficient proof to show a change in the character of taxpayer's business either in the products manufactured or in the methods of sale; (2) there was insufficient proof that the asserted change resulted in lower costs; (3) there was insufficient proof that any such alleged lower costs were not passed on to the taxpayer's customers; and (4) the evidence did not indicate any temporary circumstances which depressed business during the base period.

When this identical issue arose with respect to taxpayer's excess profits income in subsequent years, taxpayer complained that a "material," "mutual" mistake of fact had been made in the prior determination and that the doctrine of collateral estoppel ought not to apply. We need not pause to analyze all the various problems inherent in taxpayer's position. Treated in its most favorable light the alleged error occurred in certain schedules of sales submitted under stipulation to show a change in selling method. Because of this error, the court may well have found that instead of selling its nylon products directly to manufacturers as claimed, taxpayer still used jobbers during the crucial period. Even so, it can be readily seen that the failure to demonstrate the change in selling method was only one of several alternate grounds for the conclusion that base period net income had not been shown to be "abnormal." Hence despite any "material" effect the error may have had on the issue of the change in selling method, it was not "material" to the basic overall question previously litigated.

Since the parties, the issue, the "controlling" facts and the applicable law are all the same as in the earlier litigation, the doctrine of collateral estoppel is plainly applicable.

Decision affirmed.

IN THE TAX COURT OF THE UNITED STATES

(HUGUET FABRICS CORPORATION) Amended, STERN & STERN TEXTILES, INC., *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

Docket No. 33979

Decision

Pursuant to the determination of the Court, as set forth in its Opinion, filed September 11, 1956, it is

ORDERED and DECIDED: That the petitioner is not entitled to relief for the year ended September 30, 1942 under the provisions of Section 722, Internal Revenue Code.

Entered: September 14, 1956.

(Signed) JOHN E. MULRONEY
Judge.

(Seal)

[Identical Orders were entered on the same day as to the fiscal years ended September 30, 1943, 1944, 1945 and 1946.]

26 T. C. 1000

TAX COURT OF THE UNITED STATES

STERN & STERN TEXTILES, INC., Successor in Interest to HUGUET FABRICS CORPORATION, *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

Filed September 11, 1956.

Docket Nos. 31362, 33978, 33979, 53104.

Taxpayer now seeks excess profits tax relief under section 722 (b) of the 1939 Code for the taxable years ended September 30, 1942, 1943, 1944, 1945, and 1946. A prior decision of this Court, *Huguet Fabrics Corporation*, 19 T.C. 535, denied relief to the same taxpayer for the year ended September 30, 1941 on the ground of insufficiency of evidence. The issues and the collateral facts are the same in both cases. *Held*, the prior decision was a decision on the merits and the doctrine of collateral estoppel prevents the taxpayer from seeking relief in these proceedings.

Richard L. Shook, Esq., for the petitioner.

Emil Sebetic, Esq., for the respondent.

OPINION

MULRONEY, *Judge*: Petitioner corporation is successor in interest to Huguet Fabrics Corporation, the petitioner in Docket No. 7292, *Huguet Fabrics Corporation*, 19 T.C. 535. That case involved petitioner's claims for relief from excess profits taxes for its fiscal year ending September 30, 1941. The petitions filed in the four cases now before the Court allege error in the respondent's disallowance of applications for relief under section 722 (b)(1), (2), (3)(A), (3)(B), (4) and (5), Internal Revenue Code of 1939, for

the taxable years ending September 30, 1942, 1943, 1944, 1945, and 1946. The four cases were consolidated.

One of the issues raised by respondent's answer in each of the four cases was whether petitioner was barred from a hearing on the merits under the doctrine of collateral estoppel by virtue of this Court's determination in the previous case in 19 T.C. 535. We granted respondent's motion for severance of this latter issue and the collateral estoppel issue was submitted and is the only issue to be decided at this time. At the hearing certain facts were stipulated into the record and the entire record and proceedings in Docket No. 7292 were introduced by respondent, together with the Form 991 claims for the years here involved. Petitioner's evidence was designed to show that there was a mistake in the stipulation of facts in prior Docket No. 7292.

The doctrine of collateral estoppel, or, as it is sometimes called, estoppel by judgment, is that a decision on the merits in one suit precludes further litigation between the same parties of issues which were preserted, litigated and decided when the controlling facts and applicable legal rules remained unchanged. *Fairmont Aluminum Co.*, 22 T.C. 1377, and cases there cited. It is applicable to tax cases and we have held a prior determination denying relief under portions of section 722 for one year precludes consideration of claims for relief under identical portions of section 722 for later years. *Jacob's Fork Pocahontas Coal Co.*, 24 T.C. 60; *George Kemp Real Estate Co.*, 17 T.C. 755, affd. 205 F. 2d 236, certiorari denied 346 U.S. 876. Three things must be present before the principles of collateral estopped are applicable. First, there must be identity of the parties, second, there must be identity of the issues, and, third, the controlling facts and applicable legal rules must remain unchanged.

Here it was stipulated that the parties in both proceedings are identical. Petitioner makes no argument that

there is not substantial identity of issues. We have examined the entire record in both proceedings and compared the Form 991 claims and pleadings in the prior case and in the instant cases and we find the identical matters and issues decided in the prior proceeding were also raised in the instant cases. Petitioner did not allege, and does not argue, that any change has occurred in the applicable legal principles. In *Jacob's Fork Pocahontas Coal Co., supra*, we pointed out there has been no change in the legal rules applicable in section 722 cases.

Petitioner on brief narrowed his defense to the estoppel by judgment plea to the "controlling facts" requirement. His argument is that the facts of the prior case and those of the present case are different. And this is so, petitioner argues, "due to a mutual mistake of fact made by the respondent and the petitioner in a stipulation in the prior trial." Petitioner adds another argument to the effect that the collateral estoppel plea should be denied for it will result in injustice to the taxpayer.

The facts found in our prior case in 19 T.C. 535 can be incorporated here by reference but we feel it would be helpful to give a short summary by way of background for the discussion of the issues now before us.

Petitioner, a silk manufacturing company, sought relief from excess profits tax for its fiscal year ending September 30, 1941, under the provisions of section 722 (b) of the 1939 Internal Revenue Code. Respondent denied relief and in Docket No. 7292 petitioner sought to prove the denial was error on the general ground that its average base period net income is an inadequate standard of normal earnings. Its main reliance was on the allegation that it changed the character of its business during its base period by going into a new and different market with a new and different product. In Docket No. 7292 we found as a fact that petitioner commenced the manufacture and sale of fabrics manufactured from nylon in the last

quarter of its last fiscal year of its base period ended September 30, 1940. We there held this was a change from its silk and combination silk and rayon manufacturing business but the differences in the products were insufficient to satisfy the requirements of the statute. That is, the evidence of some differences which its nylon fabric possessed which distinguished it from silk or combination of silk and rayon fabrics was insufficient to establish a change in the character of taxpayer's business when it started manufacturing nylon fabric.

Our opinion in Docket No. 7292 next takes up the "further argument" advanced by petitioner that it went into a new business. This argument was that all of the nylon fabrics were in fact sold to the manufacturers of ladies' brassieres and girdles, whereas prior to the time the petitioner manufactured and sold nylon fabrics all of its sales of all of its fabrics were made through jobbers. We examined and discussed the evidence relied on to establish this point saying:

> Relevant evidence with respect to this point is contained in (1) several pages of a somewhat general and incomplete stipulation and (2) a very general statement of an interested witness, a person who was the general manager, vice president and a director of the petitioner during the taxable periods involved.
> * * *

We quoted much of the testimony of the witness referred to above and then summarized it stating it was "to the effect that during the base period petitioner sold all its nylon fabrics directly to the manufacturers of ladies' brassieres and girdles." We pointed out the witness's testimony did not identify such sales and we quoted another portion of his testimony that was confusing and cast some doubt on the accuracy of his statement that all base period sales of nylon were made to the undergarment industry.

We next looked at the stipulation which showed that in the month of September 1940 the sales to five jobbers (including sales to Wm. Cohen Fabrics, $8,579.25) totaled $81,719.84, and the total sales that month were $90,939.50, of which $10,346.45 were sales of nylon. This allowed the inference that at least $1,126.79 nylon sales were made to jobbers in September 1939, none of whom were manufacturers of undergarments.

Here is where petitioner centers his argument in the instant cases. His evidence is designed to show that the portion of the stipulation showing sales to jobber Wm. Cohen Fabrics of $8,579.25 in September 1940 was wrong; that in fact there were no sales to Wm. Cohen Fabrics in September 1940 at all; that this was a mutual mistake of fact in the stipulation, and the true fact is the sales to jobbers in the month of September 1940 were $73,140.59. Petitioner's argument is that in Docket No. 7292 our "decision turned upon this finding" that $1,126.79 nylon sales were made to jobbers showing no clear-cut change in selling policy by the petitioner such as to warrant the application of section 722. From this he argues the *facts* in the instant cases are different from the *facts* in the prior case and thus one of the essential elements for the application of collateral estoppel is not present.

We need not go into the question of whether petitioner's evidence establishes no sales were made to Wm. Cohen Fabrics in September 1940. We can assume it does. The controlling facts were the ultimate facts or the events and results that occurred during the base period, not the evidence by which petitioner sought to establish what occurred. The allegations of fact in the instant cases were substantially identical to the allegations in the former case.

In the prior case the petitioner introduced certain evidence designed to produce a conviction in the mind as to the existence of the ultimate facts which would

warrant section 722 relief. We held that evidence insufficient. The fact that petitioner could now produce more of different evidence which would tend to prove the same ultimate facts it sought to prove in the first case does not entitle it to re-litigate the issue. Petitioner fails to distinguish between evidence and the ultimate facts to be found from the evidence introduced. The stipulation of facts was not different from the other evidence. It was merely an admission of certain evidentiary facts relieving the party of the inconvenience of making other proof. As an admission it is considered and weighed like other evidence and it is considered in the light of other evidence in arriving at the ultimate determination. Even if one or more of the evidentiary facts introduced are erroneous, the ultimate determination stands as a bar to re-litigation. If this were not so there would be no end to litigation. In *Fairmont Aluminum Co., supra*, we said at page 1381:

> Perhaps, on a different record, a different result might follow, but it is the essence of the doctrine of collateral estoppel that only one opportunity be given, in the normal course, to litigate an issue. * * *

Petitioner is in the same situation as it would be if its bookkeeper had testified as to the sales to jobbers and he was defending against the bar of the judgment on the ground his testimony as to the sales to one jobber during one month was wrong.

Petitioner had the burden of proof and the prior adjudication is based upon his failure to discharge that burden. We said in our opinion: "insufficient evidence was introduced to establish the existence during the base period of a qualifying change within the requirements of section 722 of the Code [19 T.C. 535, 547]." It cannot be said, as petitioner now argues, our decision in the prior case "turned" on this bit of evidence which petitioner now says is wrong. The petitioner in the prior

case was endeavoring to show it changed the character of its business by the stipulation and the testimony of the witness to the general effect that after it started manufacturing nylon it sold nylon fabric direct to manufacturers instead of through jobbers. We held both testimony and stipulation insufficient to establish that fact and in passing we also pointed out certain portions of the stipulation even warranted an inference it did not wholly change its method of doing business. But the opinion was not based and did not "turn" on the correctness of such inferences. It was grounded solely on the insufficiency of the evidence. We drew other inferences from other portions of the stipulation which indicated nylon sales might well have been made to jobbers in the base period and we pointed out there was a complete lack of any evidence showing nylon sales to specifically named manufacturers of brassieres and girdles until after the base period. Finally we pointed out that even if nylon sales were made to manufacturers, and, as the witness stated, the jobbers' percentages were eliminated, the petitioner failed to show the benefit of such elimination of any such commission was not passed on to the manufacturers of girdles and brassieres in the form of reduced selling prices. It is abundantly clear our opinion in the former case was on the merits and it turned on the insufficiency of the evidence. In *Fairmont Aluminum Co., supra,* we said, at page 1381:

> There is a burden of proof on some party in every case, and even though the adjudication may be rested upon a failure to discharge that burden it is nonetheless an adjudication on the merits. * * *

As a decision on the merits the estoppel of the judgment on the fact issue presented is complete.

Little need be said with respect to petitioner's other point that estoppel by judgment should not be applied be-

cause it will result in injustice. Petitioner's argument stems from language in *Commissioner* v. *Sunnen*, 333 U. S. 591, where it is stated: "where two cases involve income taxes in different taxable years, collateral estoppel must be used with its limitations carefully in mind so as to avoid injustice."

The opinion in the *Sunnen* case merely holds the doctrine of collateral estoppel should be confined to cases "where the matter raised in the second suit is identical in all respects with that decided in the first proceeding and where the controlling facts and applicable legal rules remain unchanged."

We have held the stated requirements are present here and when that is so, the *Sunnen* case holds, "the prior judgment will be conclusive as to the same legal issues which appear, assuming no intervening doctrinal change."

The application of the doctrine of collateral estoppel in tax cases is of as much benefit to taxpayers generally as to respondent. It is grounded upon the principle that re-litigation of identical issues "tends to defeat the ends of justice." *Fairmont Aluminum Co., supra.* Of interest is *Arthur Curtiss James*, 31 B.T.A. 712, wherein the taxpayer was asserting the doctrine of collateral estoppel and the Commissioner contended the prior decision was based on an erroneous fact (accumulated earnings and profits figure) contained in the stipulation, and therefore the doctrine of collateral estoppel did not apply. We held for the taxpayer saying the prior decision "conclusively established" the fact.

Decision will be entered for the respondent.

Internal Revenue Code of 1939:

CHAPTER I—INCOME TAX

* * * * *

CHAPTER 2—ADDITIOAL INCOME TAXES

* * * * *

SUBCHAPTER E—EXCESS PROFITS TAX

[As added by Section 201 of the Second Revenue Act of 1940, c. 757, 54 Stat. 974, which provided that the new subchapter may be cited as the "Excess Profits Tax Act of 1940."]

SEC. 722 [as amended by Section 222 of the Revenue Act of 1942 c. 619, 56 Stat. 798, and the Act of December 17, 1943, c. 346, 57 Stat. 601]. GENERAL RELIEF—CONSTRUCTIVE AVERAGE BASE PERIOD NET INCOME.

(a) *General Rule.*—In any case in which the taxpayer establishes that the tax computed under this subchapter (without the benefit of this section) results in an excessive and discriminatory tax and establishes what would be a fair and just amount representing normal earnings to be used as a constructive average base period net income for the purposes of an excess profits tax based upon a comparison of normal earnings and earnings during an excess profits tax period, the tax shall be determined by using such constructive average base period net income in lieu of the average base period net income otherwise determined under this subchapter. In determining such constructive average base period net income, no regard shall be had to events or conditions affecting the taxpayer, the industry of which it is a member, or taxpayers generally occurring or existing after December 31, 1939, except that, in the cases described in the last sentence of section 722 (b) (4) and in section 722 (c), regard shall be had to the change in the character of the business under sec-

tion 722 (b) (4) or the nature of the taxpayer and the character of its business under section 722 (c) to the extent necessary to establish the normal earnings to be used as the constructive average base period net income.

(b) *Taxpayers Using Average Earnings Method.*—The tax computed under this subchapter (without the benefit of this section) shall be considered to be excessive and discriminatory in the case of a taxpayer entitled to use the excess profits credit based on income pursuant to section 713, if its average base period net income is an inadaquate standard of normal earnings because—

(1) in one or more taxable years in the base period normal production, output, or operation was interrupted or diminished because of the occurrence, either immediately prior to, or during the base period, of events unusual and peculiar in the experience of such taxpayer,

(2) the business of the taxpayer was depressed in the base period because of temporary economic circumstances unusual in the case of such taxpayer or because of the fact that an industry of which such taxpayer was a member was depressed by reason of temporary economic events unusual in the case of such industry,

(3) the business of the taxpayer was depressed in the base period by reason of conditions generally prevailing in an industry of which the taxpayer was a member, subjecting such taxpayer to

(A) a profits cycle differing materially in length and amplitude from the general business cycle, or

(B) sporadic and intermittent periods of high production and profits, and such periods are inadequately represented in the base period.

(4) the taxpayer, either during or immediately prior to the base period, commenced business or changed the character of the business and the average base period net income does not reflect the normal operation for the entire base period of the business. If the business of the taxpayer did not reach, by the end of the base period, the earning level which it would have reached if the taxpayer had commenced business or made the change in the character of the business two years before it did so, it shall be deemed to have commenced the business or made the change at such earlier time. For the purposes of this subparagraph, the term "change in the character of the business" includes a change in the operation or management of the business, a difference in the products or services furnished, a difference in the capacity for production or operation, a difference in the ratio of nonborrowed capital to total capital, and the acquisition before January 1, 1940, of all or part of the assets of a competitor, with the result that the competition of such competitor was eliminated or diminished. Any change in the capacity for production or operation of the business consummated during any taxable year ending after December 31, 1939, as a result of a course of action to which the taxpayer was committed prior to January 1, 1940, or any acquisition before May 31, 1941, from a competitor engaged in the dissemination of information through the public press, of substantially all the assets of such competitor employed in such business with the result that competition between the taxpayer and the competitor existing before January 1, 1940, was eliminated, shall be deemed to be a change on December 31, 1939, in the character of the business, or

(5) of any other factor affecting the taxpayer's business which may reasonably be considered as resulting in an inadequate standard of normal earnings

during the base period and the application of this section to the taxpayer would not be inconsistent with the principles underlying the provisions of this subsection, and with the conditions and limitations enumerated therein.

* * * * *

(d) *Application for Relief Under This Section.*—The taxpayer shall compute its tax, file its return, and pay the tax shown on its return under this subchapter without the application of this section, except as provided in section 710 (a) (5). The benefits of this section shall not be allowed unless the taxpayer within the period of time prescribed by section 322 and subject to the limitation as to amount of credit or refund prescribed in such section makes application therefor in accordance with regulations prescribed by the Commissioner with the approval of the Secretary. If a constructive average base period net income has been determined under the provisions of this section for any taxable year, the Commissioner may, by regulations approved by the Secretary, prescribe the extent to which the limitations prescribed by this subsection may be waived for the purpose of determining the tax under this subchapter for a subsequent taxable year.

* * * * *

(26 U.S.C. 1952 ed., Sec. 722.)

SEC. 732 [as added by Section 9 of Excess Profits Tax Amendments of 1941, C. 412, 55 Stat. 687, and as amended by Section 222 (c) of the Revenue Act of 1942, *supra*, by Section 2 of the Joint Resolution of June 30, 1945, c. 211, 59 Stat. 295, and by Section 203 (a) of the Act of December 29, 1945, c. 652, 59 Stat. 669]. REVIEW OF ABNORMALTIES BY THE TAX COURT OF THE UNITED STATES.

(a) *Petition to Tax Court.*—If a claim for refund of tax under this subchapter for any taxable year is disallowed in

whole or in part by the Commissioner, and the disallowance relates to the application of section 711 (b) (1) (H), (I), (J), or (K), section 721 or section 722, relating to abnormalties, the Commissioner shall send notice of such disallowance to the taxpayer by registered mail. Within ninety days after such notice is mailed (not counting Saturday, Sunday, or a legal holiday in the District of Columbia as the ninetieth day) the taxpayer may file a petition with the Tax Court for a redetermination of the tax under this subchapter. If such petition is so filed, such notice of disallowance shall be deemed to be a notice of deficiency for all purposes relating to the assessment and collection of taxes or the refund or credit of overpayments.

(b) *Deficiency Found by the Tax Court in Case of Claim.*—If the Tax Court finds that there is no overpayment of tax in respect of any taxable year in respect of which the Commissioner has disallowed, in whole or in part, a claim for refund described in subsection (a) and the Tax Court further finds that there is a deficiency for such year, the Tax Court shall have jurisdiction to determine the amount of such deficiency and such amount shall, when the decision of the Tax Court becomes final, be assessed and shall be paid upon notice and demand from the collector.

(c) *Finality of Determination.*—If in the determination of the tax liability under this subchapter the determination of any question is necessary solely by reason of section 711 (b) (1) (H), (I), (J), or (K), section 721, or section 722, the determination of such question shall not be reviewed or redetermined by any court or agency except the Tax Court.

(d) *Review by Special Division of the Tax Court.*—The determinations and redeterminations by any division of the Tax Court involving any question arising under section 721 (a) (2) (C) or section 722 with respect to any taxable year shall be reviewed by a special division of the Tax Court which shall be constituted by the presiding judge and consist of not less than three judges of the Tax Court. The

decisions of such special division shall not be reviewable by the Tax Court, and shall be deemed decisions of the Tax Court.

(26 U. S. C. 1952 ed., Sec. 732.)

Regulations 112. Internal Revenue Code as Amended (for Taxable Years Beginning After December 31, 1941). (U. S. Treasury Department Bureau of Internal Revenue)

SEC. 35.722-3 DETERMINATION OF EXCESSIVE AND DISCRIMINATORY TAX; TAXPAYER ENTITLED TO EXCESS PROFITS CREDIT BASED ON INCOME.—The excess profits tax, computed without regard to the provisions of section 722, for any taxable year shall be considered to be excessive and discriminatory in the case of a taxpayer entitled to use the excess profits credit based on income pursuant to section 713 (or pursuant to Supplement A, if the taxpayer is an acquiring corporation under Supplement A) if its actual average base period net income is an inadequate standard of normal earnings for one or more of the following reasons—

* * *

(d) *Commencement or change in character of business.*— If the taxpayer has commenced business or has changed the character of its business either during or immediately prior to the base period, and if the taxpayer establishes that its average base period net income does not reflect the normal operation for the entire base period of a business so commenced or changed in character, the average base period net income shall be considered to be an inadequate standard of normal earnings.

* * *

A change in the character of the business includes changes resulting from the following activities:

(1) A change in the operation or management of the business. The introduction of new or substantially different processess of manufacturing or of new or substantially different methods of distribution would constitute a change in the operation of a business;

* * *

Examples of a change in operation or management might be the following:

* * * *

Likewise, Corporation C, which prior to 1938 marketed its product from door to door, in such year changed such sales methods to direct sales to retailers and thereafter realized profits; it would be deemed to have effectuated a change in operations. * * *

* * *

(2) A difference in the products or services furnished. A product or service is different from another product or service if the trade custom or practice treats it as a product or service of a different class. * * * Another taxpayer manufactured and sold a variety of products, some under patents it had developed. During the base period it engaged in extensive research, developed new products, perfected and obtained a patent, and employed new marketing methods, enabling it to sell a leading product never before sold in the new markets. A difference in the products furnished is deemed to have resulted.

Bulletin on Section 722 of the Internal Revenue Code (U. S. Treasury Department, Bureau of Internal Revenue, November 1944), at Pages 41-42, 44 and 48:

Law.—Section 722(b)(4).

Regulations.—Section 35.722-3(d).

(A) General Rule.

In order for a taxpayer to obtain relief through the provisions of section 722(b)(4) it must be entitled to use the excess profits credit based on income and it must establish—

(1) That it commenced business or changed the character of its business either during or immediately prior to the base period; and

(2) That because of such commencement or change in character its actual average base period net income is an inadequate standard of its normal earnings for the entire base period; and

(3) The fair and just amount representing normal earnings to be used as a constructive average base period net income.

The relief afforded by sections 722(b)(1), (2), and (3) is based upon the existence of factors which adversely affect the average base period net income. In contrast, the relief afforded by section 722(b)(4) is based upon the existence of factors which produce a higher level of normal earnings than the level of earnings which existed during the base period as a whole. If the entire base period does not reflect *normal* operations based upon the new or changed circumstances, the average base period net income is deemed to be an inadequate standard of normal earnings.

A taxpayer seeking relief under sections 722(b)(1), (2), or (3) is in effect asserting that its base period is normal except for the abnormal circumstances. Presumably, such

a taxpayer would have established its place in its industry by the beginning of its base period. It would already have experienced periods of normal operations in which normal earnings were realized. A taxpayer seeking relief under section 722(b)(4) may have no periods of normal earnings. It is requesting relief either because it did not reach during the base period an established position in its industry and its level of normal operations, or because it attained such position and level during only part of the base period. In either event, the taxpayer does not have normal earnings for the entire base period based upon such normal operating conditions.

* * *

Under section 722(b)(4), the factor causing the inadequacy in the actual average base period net income is the commencement or change in character which results in the failure of the actual average base period net income to reflect the normal operations of the new or changed business for the *entire* base period. The determination of the fair and just amount representing normal earnings therefore requires a reconstruction of earnings for the entire base period to reflect normal operations for the new or changed business. The second sentence of section 722(b)(4) provides the following rule to be used in determining the level of normal earnings at the end of the base period attributable to the new or changed business:

> If the business of the taxpayer did not reach, by the end of the base period, the earning level which it would have reached if the taxpayer had commenced business or made the change in the character of the business two years before it did so, it shall be deemed to have commenced the business or made the change at such earlier time.

This provision, known as the 2-year push-back rule, is designed to permit reconstruction of the entire base period by taking into account the level of earnings which would

have existed at the end of the base period had the taxpayer had the advantage of two years' lengthened experience under normal conditions. Theoretically, the push-back rule must be applied to all section 722(b)(4) cases to determine whether the taxpayer is entitled to use a constructive average base period net income based on a higher level of earnings than was actually reached by the end of the base period. * * *

* * *

A CHANGE IN OPERATION

The regulations provide that "The introduction of new or substantially different processess of manufacturing or of new or substantially different methods of distribution would constitute a change in the operation of a business; * * *." Included in processes of manufacturing would be formulae as well as methods of fabrication and sequence of manufacture. A general rearrangement of machinery, such as a change from ordinary to assembly line methods of manufacturing, resulting in a substantial cost saving, would be a change in the operation of a business. A change in sales distribution methods from sales through retailers to sales through agents, jobbers, brokers, door-to-door, mail order or factory branches would also constitute a change in operations.

Exhibit 4-D

HUGUET SILK COMPANY, INC.
(9/30/22—9/30/36)

HUGUET SILK CORPORATION
(9/30/37—9/30/40)

Statement of Operations

Fiscal Years Ending September 30 1922 to 1940

Fiscal Year Ending 9/30	Net Income
1922	$ 186,785.18
1923	205,794.67
1924	203,259.46
1925	220,017.41
1926	206,782.65
1927	222,821.94
1928	356,089.92
1929	339,734.29
1930	154,274.48
1931	52,968.36
1932	(66,080.75)
1933	51,344.25
1934	63,522.07
1935	78,606.82
1936	56,765.12
1937	98,397.02
1938	(14,936.68)
1939	1,151.15
1940	313.37
Total	$2,417,610.73

Exhibit 6-F

HUGUET FABRICS CORPORATION

MONTHLY STATISTICS OF SALES TO CUSTOMERS

	Total Sales	Stern & Stern	Goldenbro Fabrics Inc.	J. H. Kimball Inc.	Mann & Delaney Ben Mann Fabrics Corp.	Wm. Cohen Fabrics
1938						
• • •						
1939						
Oct.	$ 77,778.26	$ 24,101.41	$ 34,121.29	$ 2,385.58	$ 1,200.00	$ 2,013.57
Nov.	95,382.02	30,766.26	45,579.88	1,307.62	1,756.93	3,171.70
Dec.	82,946.16	27,764.66	34,710.29	2,264.10	3,382.39	2,123.15
1940						
Jan.	102,553.62	38,907.82	41,984.58	2,129.26	2,068.79	9,104.38
Feb.	105,147.37	39,249.58	46,299.64	2,701.64	2,245.93	5,078.55
Mar.	147,175.56	77,869.98	45,618.57	2,064.82	1,868.42	6,044.75
April	137,957.98	78,288.60	46,567.36	1,367.23	2,053.86	7,664.45
May	88,820.60	42,480.97	35,860.66	1,166.46	535.46	7,152.80
June	34,698.34	16,886.96	12,599.96	1,202.76	100.00	(776.13)
July	40,885.32	9,585.29	16,084.31	1,568.79	100.00	(372.09)
Aug.	43,097.20	15,093.90	11,863.47	1,552.06	300.00	——
Sept.	90,939.59	43,898.17	28,118.91	500.72	622.79	8,579.25
	$1,047,381.93	$444,893.60	$399,408.92	$20,211.04	$16,234.57	$59,784.38

Nylon Sales $16,999.69

Exhibit 7-G

HUGUET FABRICS CORPORATION

MONTHLY STATISTICS OF NYLON SALES TO CUSTOMERS

	1940	1941	1942	1943	1944
Oct.	$	$ 3,130.10	$ 96,504.75		
Nov.		14,361.21	70,320.14		
Dec.		12,691.07	100,163.09		
Jan.		4,563.51	86,386.78		
Feb.		14,268.50	88,686.17		
Mar.		29,197.50	70,826.91		
Apr.		60,632.27	64,412.94		
May		63,441.80	45,848.90		
June		52,323.38	50,389.78		
July	842.96	66,014.10	33,850.41		
Aug.	5,810.28	90,335.40	9,788.87		
Sept.	10,346.45	112,228.59	11,824.65		
Totals	$16,999.69	$523,187.43	$729,003.39		

Certified Record, United States Court of Appeals for the Second Circuit, Vol. III, Page 2:

Page 193:

(Statement of Respondent's counsel)

Mr. Wickersham: It is my understanding that in the event the Court decides the legal question against us and then finds a nylon yardage or poundage that the petitioner would have obtained from Du Pont in 1939, that the Court can assume its profit from that would be one dollar a pound and that the earlier years, 1936, 1937, and 1938, would then be reconstructed on the basis of the index, commissioner's mimeograph 5807.

The Witness: Series B.

Mr. Wickersham: Is that a correct statement of our understanding?

Mr. Cochran: That is correct.

Record on Appeal in the United States Court of Appeals for the Second Circuit, Page 16 (Transcript of Hearing of January 9, 1956, Statement of Attorney for the Respondent):

Mr. Sebetić: I think at this time it might be appropriate to include various oral stipulations in the record which both parties are desirous of making. One stipulation concerns the customers to whom the sales were made during the base period, which the Petitioner claims concern the erroneous figures. Respondent is willing to stipulate that the following base period customers who purchased fabrics from Huguet Fabrics Corporation were manufacturers as opposed to jobbers. Fay-Miss, later known as Bali Brassiere. Two: Julius Kayser & Company. Three: Endurette Corporation of America. Four: Warner Brothers.

It is also stipulated by the parties that the fabrics sold to the following customers by Huguet during the base period years in the amount of $47.17 were sold as samples and not for resale by the customers purchasing the fabrics. One: E. I. duPont deNemours & Company. Two: National Association of Dyers & Cleaners. Three: Stern & Stern Textiles, Inc.

It is further stipulated that of the seven customers to whom Huguet Fabrics Corporation sold fabrics during its base period years, only Stern & Stern Textiles, Inc. was a jobber.

Record on Appeal in the United States Court of Appeals for the Second Circuit, Page 707:

Filed October 10, 1956

THE TAX COURT OF THE UNITED STATES

Docket Nos. 31362, 33978, 33979, 53104

STERN & STERN TEXTILES, INC. (Successor in Interest to Huguet Fabrics Corporation), *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

MOTION FOR REVIEW OF THE OPINION BY THE SPECIAL DIVISION OF THE TAX COURT

Comes now the petitioner, through its attorney, Howe P. Cochran, and moves this honorable Court to set this matter down for a review by the Special Division of the Tax Court.

As reason for this motion, petitioner respectfully states that this cause was based on a claim for relief from excess profits tax under Section 722 of the Internal Revenue

Code, and that this Hearing had to do with a plea of collateral estoppel urged by the respondent, and only with such plea, but that the Court erroneously treated the hearing on collateral estoppel as a hearing on the merits, although the only evidence offered had to do with the plea of collateral estoppel; that the Court found the facts urged and proved by the petitioner in connection with the plea of respondent of collateral estoppel to be true, and then in error decided the case against the petitioner on the merits, instead of for the petitioner on the collateral estoppel plea of the respondent; that the Court went into matters that would and could only be offered at a trial on the merits, and reached a decision on the merits when the merits of the case were not before it.

Petitioner further states that Section 732 of the Internal Revenue Code, subsection (d) states that "The determinations and redeterminations by any division of the Board involving any question arising under section 721 (a) (2) (C) or section 722 with respect to any taxable year shall be reviewed by a special division of the Board which shall be constituted by the Chairman and consist of not less than three members of the Board."

An Opinion by one Judge was filed in this cause on September 11, 1956, and such Opinion and the Decision based thereon precluded the petitioner from pursuing its remedies in this honorable Court.

The Decision entered pursuant to the aforementioned Opinion, in which Decision the Court found that petitioner was not entitled to relief under Section 722, was filed on September 14, 1956.

The Decision was in error in two particulars: (1) It failed to hold that the rule of collateral estoppel did not apply because of a proved mutual mistake of fact made by both the respondent and the petitioner in the prior trial; and, (2) The Decision was a decision on the merits.

when the case had not been tried on the merits; for the case was tried only on the collateral estoppel issue.

Petitioner urges that it is entitled, as a matter of law, to a review by the Special Division, or the right to appeal to the full Court or to the Circuit Court of Appeals.

WHEREFORE, it is respectfully prayed that this motion be granted.

Respectfully submitted,

H. P. COCHRAN
Howe P. Cochran
421 New Jersey Avenue, S. E.
Washington 3, D. C.
Attorney for Petitioner

Record on Appeal in the United States Court of Appeals for the Second Circuit, Page 709:

THE TAX COURT OF THE UNITED STATES

Docket Nos. 31362, 33978, 33979, 53104

STERN & STERN TEXTILES, INC. (Successor in Interest to Huguet Fabrics Corporation), *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

MOTION FOR REVIEW BY THE FULL COURT

Comes now the petitioner, through its counsel, Howe P. Cochran, and respectfully moves this honorable Court to set this matter down for a review by the full Court.

As reason for this motion, petitioner respectfully states as follows: That this cause arose under Section 722 of the Internal Revenue Code, and the hearing under con-

sideration was in connection with a plea of collateral estoppel; that the petitioner proved its point; and that the Court thereupon erroneously decided that the case against the petitioner on its merits, ignoring the collateral estoppel aspects of the case under which it was tried, notwithstanding the fact that the petitioner had admittedly proved its point on the collateral estoppel issue as tried; that the Opinion was promulgated on September 11, 1956, and Decision entered on September 14, 1956. The petitioner further states that the case was decided by one Judge, and was not reviewed by the Special Division of the Tax Court, as required by law; that petitioner has this day filed a motion seeking review; that in the event said motion be denied, petitioner desires a hearing by the full Court, and files this motion to protect its rights. A memorandum and brief setting forth the petitioner's position is attached hereto and made a part hereof.

WHEREFORE, it is respectfully prayed that if petitioner's Motion for Review by the Special Division of the Tax Court is denied, that the Court then entertain and grant this Motion for Review by the Full Court.

Respectfully submitted,

H. P. COCHRAN
Howe P. Cochran
421 New Jersey Avenue, S. E.
Washington 3, D. C.
Attorney for Petitioner

Record on Appeal in the United States Court of Appeals for the Second Circuit, Page 578:

THE TAX COURT OF THE UNITED STATES

WASHINGTON

Docket Nos. 31362, 33978, 33979

HUGUET FABRICS CORPORATION, *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

ORDER

Respondent filed herein a Motion To Sever The Issues asking that the Court hear and determine first and apart from the other issues in these proceedings whether the doctrine of *res judicata* and/or collateral estoppel bars the petitioner as a matter of law from a hearing on the merits of its applications for relief under section 722 of the Internal Revenue Code with respect to the taxable years ended September 30, 1942 to 1945, inclusive, by virtue of the prior decision of this Court in *Huguet Fabrics Corporation* v. *Commissioner of Internal Revenue*, Docket No. 7292. A hearing was held on said motion on January 13, 1954, at which both parties appeared by counsel who presented oral argument. The motion was taken under advisement by the Court and time was granted to the parties within which to file memoranda. After due consideration of said motion, the arguments of counsel, the memoranda filed herein and the entire record, it is

ORDERED: that respondent's said motion be and it is hereby granted, and it is further

ORDERED: that these proceedings be restored to the trial calendar for hearing upon the issue as above stated.

(Signed) JOHN W. KERN
Judge.

Dated: Washington, D. C.
November 5, 1954

INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statute involved	2
Statement	2
Argument	5
Conclusion	10
Appendix	11

CITATIONS

Cases:

Bradford Machine Tool Co. v. *Commissioner*, 260 F. 2d 950	4
Brown Paper Mill Co. v. *Commissioner*, 255 F. 2d 77, certiorari denied, 358 U.S. 906, rehearing denied, 358 U.S. 942	4
Commissioner v. *Sunnen*, 333 U.S. 591	5, 6
Cromwell v. *County of Sac*, 94 U.S. 351	5
Crowell-Collier Pub. Co. v. *Commissioner*, 259 F. 2d 860, certiorari denied, 358 U.S. 928	4
Davenport Hosiery Mills, Inc. v. *Commissioner*, 28 T.C. 201	6
Helms Bakeries v. *Commissioner*, 263 F. 2d 642, certiorari denied, 360 U.S. 903, petition for rehearing filed July 1, 1959	4
Huguet Fabrics Corp. v. *Commissioner*, 18 T.C. 605	3
Huguet Fabrics Corp. v. *Commissioner*, 19 T.C. 535	3
Jacob's Fork Pocahontas Coal Co. v. *Commissioner*, 24 T.C. 60	5
Kemp, George, Real Estate Co. v. *Commissioner*, 17 T.C. 755, affirmed, 205 F. 2d 236, certiorari denied, 346 U.S. 876	5
Kemp, George, Real Estate Co. v. *Commissioner*, 205 F. 2d 236, certiorari denied, 346 U.S. 876	4

Cases—Continued

	Page
Parker v. *Westover*, 221 F. 2d 603	7
Patent Button Co. v. *Commissioner*, 256 F. 2d 726	4
Standard Hosiery Mills v. *Commissioner*, 249 F. 2d 469	4
Tait v. *Western Md. Ry. Co.*, 289 U.S. 620	5
United States v. *International Building Co.*, 345 U.S. 502, rehearing denied, 345 U.S. 978	5

Statutes:

Internal Revenue Code of 1939:	
Sec. 722 (26 U.S.C. 1952 ed., Sec. 722)	2, 3, 4, 5, 7, 8, 9, 11
Sec. 732 (26 U.S.C. 1952 ed., Sec. 732)	2, 5, 7, 8, 13

In the Supreme Court of the United States

OCTOBER TERM, 1959

No. 236

STERN & STERN TEXTILES, INC. (SUCCESSOR IN INTEREST TO HUGUET FABRICS CORPORATION), PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (Pet. 10a–17a) is reported at 26 T.C. 1000. The opinion of the Court of Appeals (Pet. 4a–9a) is reported at 263 F. 2d 538.

JURISDICTION

The judgment of the Court of Appeals (Pet. 3a) was entered on February 2, 1959. A petition for rehearing was denied (Pet. 2a) on March 23, 1959. The petition for certiorari was filed on July 21, 1959, to which date the time for filing had been extended by an order (Pet. 1a) by Mr. Justice Harlan on June 15, 1959. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the Court of Appeals was correct in affirming the Tax Court's holding that, upon the facts here, by reason of the Tax Court's decision on the merits in a prior case denying the taxpayer's claim for excess profits tax relief under Section 722 of the Internal Revenue Code of 1939 with respect to its fiscal year 1941, the taxpayer was barred by the doctrine of collateral estoppel from again litigating upon the same grounds in these proceedings its claims for relief under Section 722 with respect to its fiscal years 1942 through 1946.

STATUTE INVOLVED

The pertinent provisions of Sections 722 and 732 of the Internal Revenue Code of 1939 are set forth in the Appendix, *infra*, pp. 11–14.

STATEMENT

In these proceedings (later consolidated (Pet. 11a)), the taxpayer [1] sought a redetermination of the Commissioner's disallowance of its applications for excess profits tax relief under Section 722 of the Internal Revenue Code of 1939 with respect to its fiscal years ended September 30, 1942 through 1946. Hearing the cases upon the severed issue of collateral estoppel, the Tax Court held that, under that doctrine, the taxpayer was precluded from re-litigating on the merits in these proceedings its right to Section 722 relief as to its fiscal years 1942 through 1946, by reason of the final decision on the merits in a prior case,

[1] The term "taxpayer" refers also, when applicable, to the taxpayer's predecessor in interest, Huguet Fabrics Corporation.

Huguet Fabrics Corp. v. *Commissioner*, 19 T.C. 535,[2] holding that the taxpayer was not entitled to any Section 722 relief, upon identical grounds, with respect to the fiscal year 1941. (Pet. 10a-17a.)

In the Tax Court, the taxpayer "narrowed" (Pet. 12a) its defense to the collateral estoppel plea to the single contention that there was a difference in the "controlling facts" of the prior case and those of the instant cases[3]—the taxpayer claiming that the prior case had "turned" (Pet. 14a) upon an alleged "mutual mistake" (Pet. 12a) as to one factual detail[4] in a stipulation of facts in the prior case.[5] The Tax Court, assuming

---

[2] That opinion supplanted, upon reconsideration, an earlier opinion of the Tax Court, likewise adverse to the taxpayer, *Huguet Fabrics Corp.* v. *Commissioner*, 18 T.C. 605.

[3] All other requirements for the application of collateral estoppel were satisfied, the Tax Court pointed out (Pet. 11a-12a), since the identity of the parties was stipulated, the identity of issues was not challenged, and no change in the applicable legal rules had intervened. The taxpayer's position against the application of collateral estoppel was similarly limited in the Court of Appeals to the contention that there was a change in the controlling facts. (Pet. 6a.)

[4] Namely, in the tabulation of the taxpayer's monthly statistics of sales to customers (Exhibit 6-F (Pet. 29a)) the amount of sales to one (the Cohen concern) in the month of September, 1940.

[5] The taxpayer's effort (Pet. 27-28) to charge the Commissioner with responsibility for the alleged error, apparently on the theory that the "incorrect stipulation was asked for" (Pet. 27) or "requested" (Pet. 7) by the Commissioner, is contrary to the evidence. Testimony of one of the taxpayer's own witnesses disclosed that the information which was in the stipulation in the prior case had been originally furnished by the taxpayer's counsel to the Commissioner's counsel, and that the latter merely prepared the draft of the proposed stipulation, and the document which became Exhibit 6-F, attached to the stipulation (and which document contained the alleged error (Pet. 10-11)), was actually a photostatic copy of one of several schedules (containing facts presumably ac-

(without deciding) that the taxpayer's evidence adduced at the hearing in these proceedings established the alleged error in the stipulation in the prior case (Pet. 14a), nevertheless decided adversely to the taxpayer because it concluded that the decision against the taxpayer in the prior case had not in fact turned upon that one "bit of evidence" (Pet. 15a), but had instead been grounded upon a failure of proof on the part of the taxpayer, i.e., upon the failure of the taxpayer to meet its burden of establishing that its base period earnings were an inadequate standard of normal earnings and of establishing the existence of "ultimate facts" which would justify the granting of Section 722 relief (Pet. 14a–16a).

The Court of Appeals affirmed (Pet. 4a–9a),* concluded

---

curately taken from the taxpayer's records) submitted by the taxpayer, through its counsel, to the Commissioner. (See unprinted Transcript of Hearing before the Tax Court in these proceedings, pp. 48–49, 54, 55–58.)

* Adhering to its prior holding in *George Kemp Real Estate Co.* v. *Commissioner*, 205 F. 2d 236, certiorari denied, 346 U.S. 876, the Court of Appeals held that it had jurisdiction to review the decision of the Tax Court "despite the provisions of § 732(c)" of the 1939 Code. (Pet. 5a.) The Commissioner had suggested that, in the light of more recent cases—see *Standard Hosiery Mills* v. *Commissioner*, 249 F. 2d 469 (C.A. 4th); *Brown Paper Mill Co.* v. *Commissioner*, 255 F. 2d 77 (C.A. 5th), certiorari denied, 358 U.S. 906, rehearing denied, 358 U.S. 942; *Patent Button Co.* v. *Commissioner*, 256 F. 2d 726 (C.A. 6th); *Crowell-Collier Pub. Co.* v. *Commissioner*, 259 F. 2d 860 (C.A. 2d), certiorari denied, 358 U.S. 928; and *Bradford Machine Tool Co.* v. *Commissioner*, 260 F. 2d 950 (C.A. 6th); see also *Helms Bakeries* v. *Commissioner*, 263 F. 2d 642 (C.A. 9th), certiorari denied, 360 U.S. 903, petition for rehearing filed July 1, 1959—there was at least a serious doubt as to jurisdiction, since the sole issue in these proceedings was as to the taxpayer's right to relief under Section 722, and the determi-

ing that (Pet. 9a) collateral estoppel was plainly applicable since "the parties, the issue, the 'controlling' facts and the applicable law are all the same as in the earlier litigation".

ARGUMENT

The courts below correctly refused to allow the taxpayer to litigate again in these proceedings as to later years the identical matter—i.e., the right to excess profits tax relief under Section 722, upon the same ground under subsection (b)(4)—decided on the merits adversely to the taxpayer in an earlier case as to a prior year. See *Commissioner* v. *Sunnen*, 333 U.S. 591; *Tait* v. *Western Md. Ry. Co.*, 289 U.S. 620; and *Cromwell* v. *County of Sac*, 94 U.S. 351; cf., *United States* v. *International Building Co.*, 345 U.S. 502, rehearing denied, 345 U.S. 978. See also *George Kemp Real Estate Co.* v. *Commissioner*, 17 T.C. 755, affirmed, 205 F. 2d 236 (C.A. 2d), certiorari denied, 346 U.S. 876, and *Jacob's Fork Pocahontas Coal Co.* v. *Commissioner*, 24 T.C. 60, in which the doctrine of collateral estoppel was applied in cases involving claims for Section 722 excess profits tax relief. The decision below constitutes nothing more than an application to the particular facts of this case of well settled principles as to the role in tax cases of the doctrine of collateral estoppel or estoppel by judgment. There is no conflict of decisions and the case presents no question warranting review by this Court.

---

nation of the collateral estoppel question could well be regarded as made "necessary solely by reason of * * * section 722", so as to make the prohibition of Section 732(c) applicable.

1. The decision below is not, as urged (Pet. 14, 15–18), contrary to the decision of this Court in *Commissioner* v. *Sunnen, supra*. Since the matter here sought to be litigated again was identical to that decided in the prior case and the identity of the parties was stipulated, and since no change had intervened in the applicable legal rules or controlling facts, the decision below is entirely consistent with *Sunnen*, and is upon the facts unquestionably correct.

The sole contention made by the taxpayer, both in the Tax Court (Pet. 12a) and in the Court of Appeals (Pet. 6a), was that there was a difference between the "controlling facts" of the first case and those of the instant cases. Upon careful and extensive analysis, the Tax Court rejected that contention (Pet. 12a–17a), and the Court of Appeals, expressly pointing to the careful consideration by the Tax Court (Pet. 6a), correctly affirmed (Pet. 6a–9a).

The taxpayer's additional contention (Pet. 18–20), made for the first time in this Court (cf., Pet. 6a, 12a), to the effect that a "change in the legal climate" (Pet. 18) had intervened after the decision of the prior case, is wholly without merit. As the Tax Court correctly pointed out (Pet. 12a), "there has been no change in the legal rules applicable in section 722 cases"—no change has been introduced either in the statute, the applicable regulations, or the decided cases. The decision in *Davenport Hosiery Mills, Inc.* v. *Commissioner*, 28 T.C. 201, to which the taxpayer points (Pet. 19), presents merely a factual conclusion that, upon the facts there shown, a change from silk to nylon hosiery was to

be regarded as revolutionary—but cannot be construed as reflecting any change whatsoever in the legal rules applicable in Section 722 cases.[7]

2. The argument to the effect that (Pet. 14, 22–24) there should have been a review by the Special Division of the Tax Court, in keeping with Section 732(d) of the 1939 Code (Appendix, *infra*, p. 14), is without merit. It rests upon the theory (see Pet. 23) that the judge (or "division") of the Tax Court who heard the instant case "decided this case on its merits." That theory is obviously inconsistent with the taxpayer's efforts to obtain a review in the Court of Appeals,[8] for Section 732(c) would bar a review of a denial on the merits of relief under Section 722.[9] Significantly—although the taxpayer had made a request in the Tax Court for a review by the Special Division (Pet. 31a–33a), which had been denied (Pet.'s C.A. App. 3, 6, 9, 11)—the point was not raised in the Court of Appeals (cf., Pet. 6a) until the taxpayer filed its peti-

[7] There is no conflict, as urged (Pet. 14, 20–21), as to the question of collateral estoppel in tax cases, with *Parker* v. *Westover*, 221 F. 2d 603 (C.A. 9th). That case represents a situation in which the Court of Appeals concluded, unlike the courts below in the instant case, that upon the circumstances there shown there had been a "change" in the "complexion of the significant facts" (221 F. 2d, at p. 606) sufficient to lift the bar of collateral estoppel.

[8] In the Court of Appeals, the taxpayer (in its opening brief, p. 3) made six separate assignments of error specifically charging the Tax Court with refusing to permit the instant cases to be tried on their merits, and it concluded its opening brief and its reply brief, respectively, with prayers to the effect that these cases should "go to trial on the merits" and that the Court of Appeals should "order the cases * * * to be heard on their merits."

[9] Cf., footnote 6, *supra*.

tion for rehearing, in which, for the first time, it argued to the Court of Appeals (amongst other things) that the Tax Court had erred in deciding these cases on the merits without a review by the Special Division.

3. The point (Pet. 14, 24–27) that the Tax Court did not have power or authority to apply the doctrine of collateral estoppel, raised for the first time in this Court, is also without merit. No restrictions or limitations of any sort are placed upon the Tax Court, as the adjudicating tribunal, in the statute conferring jurisdiction upon it to review the Commissioner's disallowance of Section 722 relief claims, Sections 732 (a) and (b) of the 1939 Code (Appendix, *infra*, pp. 13–14).

4. Likewise without merit is the contention (Pet. 14, 28–35) that the Court of Appeals departed from the issues before it, in sustaining the Tax Court in these cases. That argument appears to rest primarily upon an incorrect interpretation of the real substance of the opinion of the Court of Appeals.

The affirmance of the Tax Court by the Court of Appeals was premised upon a recognition (Pet. 6a) that the Tax Court had given careful consideration to the taxpayer's contention that there was a difference in the "controlling" facts by reason of the alleged mutual mistake in the stipulation in the prior case; that the Tax Court had concluded that the "bit of evidence" allegedly introduced in error by the prior stipulation would not (even assuming it to be wrong) have produced a different result in the prior case; and that the Tax Court, upon analysis of the prior

case, had concluded that the denial of Section 722 relief had been upon the broader basis that the taxpayer "had not introduced sufficient evidence" to establish a "qualifying" change in the character of its business under Section 722(b)(4). Thus, the Court of Appeals indicated complete satisfaction with the Tax Court's analysis of the taxpayer's contention as to the effect of the alleged error in the stipulation in the prior case and with the conclusion reached by the Tax Court. (Pet. 6a.) Moreover, the Court of Appeals (Pet. 6a–7a) made its own examination of the prior case, and reached the same conclusion. In the course of that discussion, the Court of Appeals stated that, if the alleged error were of such character as would require a finding in this case in favor of the taxpayer (i.e., a finding that the taxpayer, within the meaning of Section 722(b), had changed the character of its business during the base period, and that its base period earnings did not reflect the normal operation for the entire base period), it would favor a reversal. However, the court concluded that the alleged error "was purely incidental and of no consequence." (Pet. 7a–8a.)[10]

[10] The reference (Pet. 8a) by the Court of Appeals, amongst other things, to the lack of evidence establishing "temporary circumstances" depressing the business during the base period—to which the taxpayer now points (Pet. 32–33) as a matter falling not under Section 722(b)(4), but under Section 722(b)(2)—may have been unnecessary, since the taxpayer no longer relied (Pet. 32) on Section 722(b)(2). Nevertheless, this is of no consequence, since, even without or aside from the reference to "temporary circumstances", the decision below would remain a correct application of the doctrine of collateral estoppel.

CONCLUSION

For the foregoing reasons, the petition should be denied.

Respectfully submitted.

J. LEE RANKIN,
Solicitor General.
CHARLES K. RICE,
Assistant Attorney General.
LEE A. JACKSON,
HARRY MARSELLI,
Attorneys.

AUGUST 1959.

APPENDIX

Internal Revenue Code of 1939:

SEC. 722 [as added by Section 201 of the Second Revenue Act of 1940, c. 757, 54 Stat. 974, and as amended by Section 222 of the Revenue Act of 1942, c. 619, 56 Stat. 798, and the Act of December 17, 1943, c. 346, 57 Stat. 601]. GENERAL RELIEF—CONSTRUCTIVE AVERAGE BASE PERIOD NET INCOME.

(a) *General Rule.*—In any case in which the taxpayer establishes that the tax computed under this subchapter (without the benefit of this section) results in an excessive and discriminatory tax and establishes what would be a fair and just amount representing normal earnings to be used as a constructive average base period net income for the purposes of an excess profits tax based upon a comparison of normal earnings and earnings during an excess profits tax period, the tax shall be determined by using such constructive average base period net income in lieu of the average base period net income otherwise determined under this subchapter. * * *

(b) *Taxpayers Using Average Earnings Method:*—The tax computed under this subchapter (without the benefit of this section) shall be considered to be excessive and discriminatory in the case of a taxpayer entitled to use the excess profits credit based on income pursuant to section 713, if its average base period net income is an inadequate standard of normal earnings because—

* * * * *

(4) the taxpayer, either during or immediately prior to the base period, commenced business or changed the character of the business

and the average base period net income does not reflect the normal operation for the entire base period of the business. If the business of the taxpayer did not reach, by the end of the base period, the earning level which it would have reached if the taxpayer had commenced business or made the change in the character of the business two years before it did so, it shall be deemed to have commenced the business or made the change at such earlier time. For the purposes of this subparagraph, the term "change in the character of the business" includes a change in the operation or management of the business, a difference in the products or services furnished, a difference in the capacity for production or operation, a difference in the ratio of nonborrowed capital to total capital, and the acquisition before January 1, 1940, of all or part of the assets of a competitor, with the result that the competition of such competitor was eliminated or diminished. Any change in the capacity for production or operation of the business consummated during any taxable year ending after December 31, 1939, as a result of a course of action to which the taxpayer was committed prior to January 1, 1940, or any acquisition before May 31, 1941, from a competitor engaged in the dissemination of information through the public press, of substantially all the assets of such competitor employed in such business with the result that competition between the taxpayer and the competitor existing before January 1, 1940, was eliminated, shall be deemed to be a change on December 31, 1939, in the character of the business, or

* * * * *

(d) *Application for Relief Under This Section.*—The taxpayer shall compute its tax, file its return, and pay the tax shown on its return under this subchapter without the application of this section, except as provided in

section 710(a)(5). The benefits of this section shall not be allowed unless the taxpayer within the period of time prescribed by section 322 and subject to the limitation as to amount of credit or refund prescribed in such section makes application therefor in accordance with regulations prescribed by the Commissioner with the approval of the Secretary. If a constructive average base period net income has been determined under the provisions of this section for any taxable year, the Commissioner may, by regulations approved by the Secretary, prescribe the extent to which the limitations prescribed by this subsection may be waived for the purpose of determining the tax under this subchapter for a subsequent taxable year.

* * * * *

(26 U.S.C. 1952 ed., Sec. 722.)

SEC. 732 [as added by Section 9 of Excess Profits Tax Amendments of 1941, c. 10, 55 Stat. 17, and as amended by Section 222(c) of the Revenue Act of 1942, *supra*, by Section 2 of the Joint Resolution of June 30, 1945, c. 211, 59 Stat. 295, and by Section 203(a) of the Act of December 29, 1945, c. 652, 59 Stat. 669]. REVIEW OF ABNORMALITIES BY THE TAX COURT OF THE UNITED STATES.

(a) *Petition to the Tax Court.*—If a claim for refund of tax under this subchapter for any taxable year is disallowed in whole or in part by the Commissioner, and the disallowance relates to the application of section 711(b)(1)(H), (I), (J), or (K), section 721 or section 722, relating to abnormalities, the Commissioner shall send notice of such disallowance to the taxpayer by registered mail. Within ninety days after such notice is mailed (not counting Saturday, Sunday, or a legal holiday in the District of Columbia as the ninetieth day) the taxpayer may file a petition with the

Tax Court of the United States for a redetermination of the tax under this subchapter. If such petition is so filed, such notice of disallowance shall be deemed to be a notice of deficiency for all purposes relating to the assessment and collection of taxes or the refund or credit of overpayments.

(b) *Deficiency found by the Tax Court in case of claim.*—If the Tax Court finds that there is no overpayment of tax in respect of any taxable year in respect of which the Commissioner has disallowed, in whole or in part, a claim for refund described in subsection (a) and the Tax Court further finds that there is a deficiency for such year, the Tax Court shall have jurisdiction to determine the amount of such deficiency and such amount shall, when the decision of the Tax Court becomes final, be assessed and shall be paid upon notice and demand from the collector.

(c) *Finality of Determination.*—If in the determination of the tax liability under this subchapter the determination of any question is necessary solely by reason of section 711 (b)(1) (H), (I), (J), or (K), section 721, or section 722, the determination of such question shall not be reviewed or redetermined by any court or agency except the Tax Court.

(d) *Review by Special Division of the Tax Court.*—The determinations and redeterminations by any division of the Tax Court involving any question arising under section 721(a)(2)(C) or section 722 with respect to any taxable year shall be reviewed by a special division of the Tax Court which shall be constituted by the presiding judge and consist of not less than three judges of the Tax Court. The decisions of such special division shall not be reviewable by the Tax Court, and shall be deemed decisions of the Tax Court.

(26 U.S.C. 1952 ed., Sec. 732.)

U. S. GOVERNMENT PRINTING OFFICE 1959

FILE COPY

Office Supreme Court, U.S.
FILED
SEP 9 1959
JAMES R. BROWNING, Clerk

IN THE

Supreme Court of the United States

OCTOBER TERM, 1959

No. 236

STERN & STERN TEXTILES, INC. (Successor in Interest to Huguet Fabrics Corporation), *Petitioner*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

REPLY TO BRIEF FOR THE RESPONDENT IN OPPOSITION

HOWE P. COCHRAN
421 New Jersey Avenue, S.E.
Washington 3, D. C.
Attorney for Petitioner.

Of Counsel:

MARGARET F. LUERS
BETTY COCHRAN STOCKUIS

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1959

No. 236

STERN & STERN TEXTILES, INC. (Successor in Interest to Huguet Fabrics Corporation), *Petitioner*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

REPLY TO BRIEF FOR THE RESPONDENT IN OPPOSITION

Comes now the petitioner, through its counsel, Howe P. Cochran, and answers respondent's brief in opposition to the granting of a writ of certiorari in the above-entitled case.

The brief of respondent is, for the most part, a general denial of the petitioner's case, but two or three things of importance stand out.

1. On page 7, under "2", respondent says that petitioner's claim that "there should have been a review by the Special Division of the Tax Court, in keeping with Section 732 (d) of the 1939 Code is without merit."

Respondent is entirely in error.

Section 732 (d) absolutely requires a review by "a special division of the Tax Court which shall be constituted by the presiding judge and consist of not less than three judges of the Tax Court" of the "determinations and redeterminations by any division of the Tax Court *involving any question* arising under * * * Section 722 with respect to any taxable year" (italics added). Indeed, until a review has been had, the determination by any division of the Tax Court shall not be deemed to be a decision of the Tax Court, for the Code continues: "The decisions of such special division shall not be reviewable by the Tax Court, and shall be deemed decisions of the Tax Court." It is respectfully submitted that if a review was demanded by the Code, and if the decision of the reviewing body "shall be deemed" the decision of the Tax Court, then the decision by one judge of the Tax Court who refused to submit the matter to the reviewing body could not possibly have been a decision of the Tax Court.

Respondent suggests that Section 732 (c) "would bar a review of a denial on the merits of relief under Section 722."

Again he is in error.

He puts himself on the horns of a dilemma.

On the one horn, if the Tax Court, without the necessary review, attempted to "decide" this case on the grounds of collateral estoppel, an appeal to the Second Circuit would lie, first because there was no review by the Special Division of the Tax Court as required by law so as to make the "decision" a decision of the Tax Court; and second, because a plea of collateral estoppel arising in a Section 722 case, while it is a question arising under Section 722, does not involve "the determination of any question [made] necessary *solely* by reason of * * * Section 722," which is the express limitation contained in Section 732 (c) (italics added).

On the other horn, if the Tax Court, without the necessary review, attempted to decide this case on the merits, an appeal to the Second Circuit would lie because, first, there was no review by the Special Division of the Tax Court as required by law so as to make the "decision" a decision of the Tax Court such as would invoke Section 732 (c); and, second, because no administrative body acting as though it were a court, and, indeed, no court could decide a case on its merits without first allowing the case to be heard on its merits.

Respondent admits that a review by the Special Division of the Tax Court was required by the Code; and respondent admits that a review was not had, but respondent brushes aside as "without merit" the complaint that the requirements of the Code were not met.

2. Respondent's argument that the matter of the failure to afford a review by the Special Division of the Tax Court was not raised in the Second Circuit until after the decision in the Second Circuit, is not true.

This point was, in fact, raised by the petitioner in its Petition for Review to the Court of Appeals, and respondent must know that fact. On its Petition for Review to the Second Circuit in the present case, under the heading, "Nature of Controversy," the following appears:

> "Can one Judge of The Tax Court, acting alone, decide a question arising on a Section 722 relief case?" (Unprinted Record on Appeal, p. 728.)

Under "Assignments of Errors," the following appears:

> "The Tax Court erred in permitting one Judge to decide a case when the statute prescribes, in cases such as these, that a Division of The Tax Court, consisting of not fewer than three Judges shall decide such cases." (Unprinted Record on Appeal, p. 729.)

3 Respondent agrees with the petitioner that the holding made by the Second Circuit in its opinion that the petitioner had not shown that it suffered a "temporary" depression in the base period was not pertinent to the case. Here is what the respondent said in the footnote on page 9:

> "10. [That] reference (Pet. 8a) by the Court of Appeals * * * may have been unnecessary, since the taxpayer no longer relied (Pet. 32) on Section 722 (b) (2). * * * *"

Petitioner respectfully submits that the Second Circuit does not make unnecessary findings in citing the reasons why a petitioner must lose its case. The Second Circuit does not waste its time in deciding cases by reaching conclusions that are of no consequence.

It is clear that the Second Circuit was misled, and ruled against the petitioner through a misconception of the petitioner's cause of action.

Respectfully submitted,

HOWE P. COCHRAN
421 New Jersey Avenue, S. E.
Washington 3, D. C.

Attorney for Petitioner

Of Counsel:

MARGARET F. LUERS
BETTY COCHRAN STOCKVIS